



**ANSWERS TO QUESTIONS**  
SET AT  
**The Indian Institute**  
OF  
**Banker's Examinations**

**PART II**  
**( VOLUME II )**  
( Revised, Enlarged and Up-to-date )

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## PREFACE TO THE SIXTH EDITION.

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This book was conceived and published for the benefit of candidates taking up examinations of the Indian Institute of Bankers. It occurred to me that they were in need of a book which served as a guide and which furthermore, was presented in as concise a manner as was compatible with clear understanding. The continued and growing demand for the book indicated that such a need did exist and that this book met it to some extent.

In this edition I have once again taken the opportunity to revise and to rewrite some parts of the book in the light of changes which have recently happened in economic conditions. I have done this both in order to bring it up to date and because I am in hope that it may now stand for some time without needing further revision.

A work of this nature was difficult to be compiled without continual reference to the recognised authorities and to many standard text books. My acknowledgement is due and is hereby accorded to all of them.

The partition of the country brought untold sufferings upon millions of human beings who had to move from one Dominion to the other and I was one of the innumerable sufferers. The book has been published under great handicaps and I owe apology to the reader for all its shortcomings.

NEW DELHI.

L R. SUNEJA





# ECONOMICS

1936

*Question 1* — Institute a comparison between the Reserve Bank of India and the Bank of England

*Answer 1* — The Reserve Bank of India and the Bank of England both are shareholders' banks

2 Both are the creation of special legislative enactments and are not subject to the provisions of Joint Stock Companies Act of their respective countries.

3 Both the banks are Central Banking institutions and act as bankers' banks

4 Both act as bankers to their respective Governments and manage the Public Debts.

5 Both have the monopoly of note issue

6 Just as the bank of England is the pivot of the London Money Market so is the Reserve Bank of India of the Indian Money Market. Their position as the holders of the nations' ultimate cash reserves give them a pre-eminent importance and enables them to exercise a great influence on the rates of interest charged on the markets and in their respective countries generally for loans of money

7. In both the Banks, there are two separate departments—the Issue Department and the Banking-Department—and both the banks are required by law to publish certain weekly returns

*Question 2.*—Suggest some measures to scale down the permanent debt of the Indian Agriculturist.

*Answer* —The Indian peasants are over head and ears in debt. The Central Banking Enquiry Committee estimated that the total agricultural indebtedness of the British Indian Provinces was in the neighbourhood of Rs 900 crores. Indebtedness is no new thing in India. There was much debt even in pre-British period but it is an admitted fact that rural debt has shown an alarming increase during the British rule, especially in recent years. There are very many reasons that have been responsible for this indebtedness. Past indebtedness

necessitating fresh borrowing owing to the high rates of interest charged, small size of holding making it impossible for a cultivator to live within his small income without getting into debt, constantly recurring losses of cattle from draught and disease, cultivators' excessive love of litigation and extravagance in expenditure upon marriage and other domestic ceremonies, his improvidence and purchase of land at high rentals during boom periods, the decline of the cottage industries depriving ryot of an income through a subsidiary occupation in the off-season, the heaviness of land revenue and the rigidity of its collection, the modern change in the cultivators position and the facility of borrowing are a few of the causes of agricultural indebtedness. To sum up, the causes of rural debt resolve themselves into two main classes those that *compel* the agriculturist to borrow and those that *enable* him to borrow. His necessities drive him to the money-lender and his credit enables him to borrow. Once caught in this whirlpool of debt he is sucked down towards the bottom and is never able to keep his head above water.

It is not, however, so much the volume of indebtedness which gives cause for anxiety as the fact that the greater part of the debt is unproductive and carries heavy rates of interest. Furthermore the real problem of agricultural indebtedness is not how to avoid debt in future but how to scale down the permanent standing or prior debt. The strengthening and expanding of the co-operative organisation and controlling usuary by legislative acts are, no doubt, the potent remedies for arresting the future growth of unproductive debt. But the liquidation of the standing indebtedness presents an altogether different problem. It has to be remembered that in majority of the cases this chronic debt is inherited. We find children born in debt and making every feasible effort to pay the debt of the fathers and forefathers. This social tradition and the custom of succeeding generations acknowledging and paying the debts of forefathers have been exalted into a legal doctrine of the *pious obligation* to pay an ancestor's debts, enforceable in Courts of Law. Even when no assets pass and debts are not legally inherited, the debt is generally treated by the son or the heir as a debt of honour by force of tradition.

The only facility which is now available to the agriculturist for redeeming his standing debt, apart from one money-lender to repay another, is supplied by the co-operative credit organisation. But these credit societies are not a suitable agency for supplying long-term credit to the agri-

culturists and assisting him in the redemption of prior debt. Nevertheless, valuable work in redeeming the standing debt of the agriculturist can be done by co-operative land mortgage banks in localities where they exist and the further establishment of these banks should be encouraged where there is a reasonable prospect of their working successfully having regard to all the local conditions. In order, however, to satisfy the credit requirements of the large class of agriculturists who are outside the co-operative movement and to provide for substantial loans to big landlords, provincial land mortgage banks on a joint stock basis will be necessary. Another method by which the problem can be tackled is by bringing about conciliation between debtors and creditors with the object of securing a composition of the standing debt. The Central Banking Enquiry Committee opined that the most effective remedy will be found in the pursuit by the local Governments of a vigorous policy of debt Conciliation on a voluntary basis. The Committee also suggested that in view of the importance of the subject, the Government concerned should explore the possibility and desirability of undertaking other legislation to secure the settlement of debts on a compulsory basis.

*Question 3* — Show how the import of foreign goods has affected the rural economy of India ?

*Answer* — Amongst the effects on Indian Economic conditions of the increased imports of manufactured goods, the most serious are those produced on the rural industries of the countries. Many cottage industries which provided means of livelihood to thousands of the poor labourers and also afforded opportunities to the agricultural labour to and to their scanty income derived through agriculture have died. Handloom industry, once a leading industry in the country has practically died out owing to the influx of machine made cotton goods, imposed of brass-sheets have reduced the demand for brass foundries, dyeing industry is in a decaying conditions because of the competition with synthetic dyes. On the whole, cottage industries which had attained a considerable magnitude a century ago and which were capable of supplying not only the wants of the people but also of exporting their products to meet a heavy foreign demand have lost their former ascendancy. The loss of industrial occupations has been followed by an extraordinary demand for land, this land-hunger has resulted in the fragmentation and sub-division of agricultural holdings till many of them have become uneconomic and those who cultivate them have become involved in debt. The supplement-

any income from handloom weaving and other occupations which might otherwise have enabled the cultivators to avoid falling into the hands of the moneylender is no longer readily available. Thus, there has been a great increase in the agrarian debt of our country.

*Question 4* — Given the necessary fiscal autonomy what should be the policy of the Government of India, Free-trade, Imperial preference or Protection

*Answer* — The Great War has dislodged free trade from her stronghold and almost all countries have become protectionists. To protect their infant industries and to make themselves self-sufficient, all leading nations of the world have set up huge tariff barriers against the imports of foreign manufactures. England, once a great supporter of Free trade, has converted herself into a protectionist. Under such circumstances India will be taking a wrong step if it adopted a policy which other nations are gradually abandoning. India is passing from the state of agriculture to one of industry, her industries are still infant and, in consequence, will be driven to wall if the well-established and gigantic industries of the world are allowed to compete. India has natural advantages for the production of certain commodities but she cannot take to industrialization unless she is helped by the Government. Free Trade cannot be adopted by India in her present state of industrial development.

Imperial preference means nothing more than a differential treatment to be accorded to the countries within the British Empire so far as the international trade is concerned. The object is to turn the whole British Empire into a self-sufficient unit free from any economic subjection. The scheme suggests the adoption of free trade policy within the Empire and recommends the inter-change of commodities between different parts without any duty or with only a nominal duty but a different sort of treatment should be accorded to foreigners.

If India adopts this scheme, she will have to impose heavier duties upon manufactured commodities that are imported from foreign countries with the result that the price of these commodities will rise. The consumers of these articles will suffer. In the second place, the imposition of such heavier duties upon foreign goods may give rise to retaliation and the foreigners may restrict the importation of Indian goods into their own countries. India exports raw material and foodstuffs which are in great demand in countries other

than those included in the British Empire. India has very little trade with Empire countries (excepting England), and she has not much to gain by adopting the scheme of Imperial Preference. Again, there are articles of export in which she has her competitors within the Empire—Australia, Canada, New Zealand etc.—and she will derive little or no benefit from the exportation of those articles. She will on the one hand lose her outside markets and, on the other will, have to face competition from other Empire countries in a market limited to the Empire.

As regards imports, the adoption of the scheme will seriously affect the infant industries of India. Preference will be equivalent to the grant of bounty to the British manufacturer at the expense of the Indian consumer. It will not be possible for the indigenous industries to compete with British manufactures and the country as a whole will suffer. It is needless here to add that India will lose a part of her customs revenue by restricting imports from foreign countries by the imposition of heavy taxes. Considering all these factors it is not unsafe to conclude that India cannot expect to gain much if she adopts Imperial Preference. We may assert that the panacea of all the industrial and economic ills of India lies in protection. The present miserable condition of India is due to her absolute dependence upon agriculture and her economic prosperity cannot be ensured unless and until there has been a diversification of industry. The Fiscal commission held the opinion that "the industrial development of India has not been commensurate with the size of country, its population and its natural resources, and that a considerable development of Indian Industries would be very much to the advantage of the country as a whole." This development cannot be effected without the Government protecting infant industries by imposing protective duties upon foreign competition. India does not need out and out protection. Those industries in which India has no chance of success may not be protected for it will be baneful to the interest of the country if such industries are protected. There are, however, industries in which it has certain natural advantages and these ultimately flourish if protection is granted to them during their infant stage. Thus we come to the policy of discriminating protection recommended by the Fiscal Commission. This suggests the extension of protection to industries which possess natural advantages showing possibility of their development in future. India requires some great stimulus to shake off the conservatism of capital and labour and this can be done by Protection alone. Protection will also benefit agriculture in

many ways India would have a steady home market for her raw materials; pressure on the produce of land would be reduced and the rise in agricultural wages will compensate the labourers for increase costs they will have to pay for protected articles

But the conditions have now changed India has acquired independence In the past industrial development in the country was hindered by a wrong tariff policy of the Government. Our tariff policy has never been national It continued to be dominated by foreign commercial interests, All this must end now in case we want to develop the country industrially Our final policy needs to be reconditioned so as to suit our special requirements.

In this connection there are some points which should receive our consideration In the first place, the formula of discriminating protection needs to be replaced by a more liberal and straightforward formula This is necessary because of the infant character of our country What should weigh with us while formulating a scheme of industrial protection is the 'infant country' and not 'infant industry', argument Secondly, its application must be made in a comprehensive manner So far the application has been in a very haphazard and piecemeal fashion Finally, the tariff machinery and the procedure for protection also need drastic changes The Indian Tariff Board should be a permanent body with statutory powers Its constitution and functions should be such as to enable it to act quickly and effectively It should make a continuous study of tariff changes, commercial treaties, trade movements, and prices in the world, especially those in which India is interested In the light of these, it should suggest suitable changes in the Indian Tariff policy, if and when considered necessary To enable it to carry out these varied but highly essential functions, it is necessary that the Board should have full discretion in the performance of its duties

We must also adopt a clear attitude towards the demand for free international trade and a demand which is based on the answerable plea that a world economy built on an expansionist rather than a contractionist outlook on trade is in the long run the best for all countries India should develop an international outlook in economic matters and respond to any reasonable appeal which may be made to her for economic co-operation with other nations. But all the same we must not forget the brutal facts of our deplorable economic stagnation. Ours is a backward and ill-balanced economy As such we can, in no case, be a party to any concealed version of

international *laissez faire*. Such a policy might easily suit industrially advanced countries like the U S A, but for India it would simply result in the perpetuation of the existing undeveloped economic structure. India as yet has much leeway, to make in regard to economic development. She must, therefore, be given the right to afford seasonable protection essential for its industrial development, irrespective of current economic doctrines in industrially advanced countries. Not to concede to India and other backward countries of the world the right to use protective devices for developmental purposes will be highly unjust, particularly in view of the fact that the U S A and every one of the industrially advanced countries have made ample and free use of protective tariffs and other devices to promote industrial growth throughout their economic history.

**Question 5.**—Describe the activity and estimate the usefulness of the Indian Tariff Board.

**Answer**—The Indian Tariff Board is the natural result of the decision of the Government of India to change the fiscal policy and adopt a policy of protection to be applied with discrimination. This decision was based on the findings of the Fiscal Commission that the industrial development of India had not been commensurate with the size of the country, its population and its natural resources and that the fullest development must be aimed at by a policy of judicious protection. The Fiscal Commission also laid down the guiding principles of such a policy and recommended that a permanent Tariff Board be created whose duties will be *inter alia* to investigate the claims of particular industries, to protect, to watch the operation of the Tariff, and generally to advise Government and the Legislature in carrying out the policy of discriminate protection. The Legislative Assembly accepted these recommendations and the Tariff Board was appointed in March, 1923, and since then it has acted as an investigating and advisory body to the Government.

The Indian Tariff Board examined about fifty cases referred to it between 1924 and 1939 and as a result of its recommendations protection was extended to a number of industries, such as iron and steel, cotton, sugar, paper, matches and heavy chemicals. Aided by protection most of these industries have greatly developed. The table below which records progress of protected industries between 1922-23 and 1939-40 in terms of production figures, bears it out.



Year	Steel Ingots (thou- sand tons).	Cotton Piece- goods (Million Yds)	Sugar from Cane (thou- sand tons)	Matches (Gross in Lakhs	Paper (Thousand tons)
1922-23	131	1725	24	8	24
1939 40	1070	4013	1242	220	70

The development of match and sugar industry was so rapid that by 1939 the country had become practically self sufficient with regard to these two commodities, while partial self-sufficiency was reached in case of cotton, pig iron, steel and paper. That the protective tariff had a great hand in the growth of these industries cannot be denied.

The successes which the protected industries have met have strengthened the opinion held in favour of the continuance of the Tariff Board. It is not fair to belittle the value of this small body. It has conferred great many advantages upon the country by recommending the case of certain industries to the government for protection and thus has indirectly assisted in the industrialisation of India. The policy pursued by the Tariff Board has been amply justified by the results of protection granted to the selected industries. The protected industries have under the aegis of protection, acquired, in a short time a position which under free trade, they would never have achieved even after labours of a hundred years.

That the tariff machinery has certain inherent defects cannot be denied. The Indian Tariff Board is an *ad hoc* body constituted from time to time whenever the case of an industry for protection comes up for consideration. For every industry a new Tariff Board is appointed. This practice of appointing different Boards at different times stands in the way of quick decisions as every new member would take time to familiarise himself with the intricacies of tariff mechanism. The members due to frequent changes lack width and continuity of experience which affects the working of the Board.

Secondly, the functions of the Tariff Board are narrow and individualistic. Each industry is considered separately and its claims to protection are examined without reference to the problems of industrialisation as a whole.

Thirdly, the procedure of protection is also desperately slow and too dilatory. An application for protection has to pass through several bottlenecks before its fate is finally decided by the Government. Much time is lost in making references backward and forward. Such a slow moving machinery can little meet the situation on commercial front where rapid changes take place. The industry may be actually dying but no instantaneous relief can be given under the existing procedure.

Thus, the constitution, functions and the procedure of the Tariff Board are not such as to render an effective and timely aid to the industries.

*Question 6.*—Write notes on the following —

(a) Dumping.

(b) *Laissez Faire*.

(c) Law of Comparative Costs.

*Answer* —(a) *Dumping* —This term means the sale of goods in a foreign country at a price much lower than that charged in the home market for the same kind and quality of goods. A firm abroad that enjoys monopolistic or other advantages may charge comparatively high prices in its own country, but wishing to secure the advantages of large scale production and increasing returns may produce more than is absorbed by the home market. The surplus may be "dumped" in other countries at lower prices than in the country of origin and appreciably below the costs in the importing countries. Frequently, articles may be dumped in a country at low prices by foreign organisations in order to drive the home producer off the market and as soon as this object is achieved price may be raised again.

(b) *Laissez Faire* means non-interference by the State in economic activities of man. The fundamental idea is that industry and trade should be allowed to go its own way unhampered by State regulation. The modern doctrine of free trade is based on this principle.

The policy of non-interference has its benefits and evils. So far as production is concerned, this policy brought immense increase since the producers reaped the benefits themselves, but it resulted in a most inequitable distribution of the created wealth among the classes which had contributed to its production. It led to the widespread evils of the

factory systems, to the sordid exploitation of the works and to the terrible oppression of the poorer classes. It came to be acknowledged, therefore, that certain services of great utility to the community cannot be left to private enterprise either because of their magnitude or absence of reward. State intervention became necessary and we find once again that there are many economic activities initiated and led by the State.

(c) *The Theory of Comparative Costs* as applied to international trade is that each country tends to produce, not necessarily what it can produce more cheaply than another country, but those articles which it can produce at the greatest relative advantage; i.e., at the lowest comparative cost. This tendency is usually known as the Law of Comparative Costs, which, as applied to international trade, states that a country tends to specialize in those commodities in the production of which it has the greatest comparative advantage. England is the finest dairy country in the world but still it relies on Denmark for butter and cheese. The answer for this paradoxical position is that it pays England better to concentrate on manufactures and to obtain much of her supplies of butter from Denmark because she thereby obtains a greater relative advantage. England wants butter and Denmark wants machinery. England prefers to get the butter from Denmark rather than produce it herself because she is thus able to employ her labour and capital in other more profitable occupations. For the same reason Denmark produces butter and buys machinery. In the long run, both sides benefit by such an arrangement. England obtains less costly butter and Denmark less costly machinery and in both countries there is an economy of both capital and effort in obtaining the same satisfaction. From the Law of Comparative Costs, it follows that it may be advantageous to a country to import something from another country even though she can produce it herself more cheaply.

*Question 7* — "Imports are paid for by exports." Discuss.

*Answer.* — See answer to Question No. 8, Economics, 1946.

*Question 8* — Explain the position of the Exchange Banks in the foreign trade of India. Would you advocate the imposition of any restriction on the operations of such banks?

*Answer.* — The Exchange Banks form an important part of the banking organisation in India. They mainly finance

the external trade of the country and have come to enjoy a virtual monopoly in the exchange business. Till the Reserve Bank of India came into existence, the Imperial Bank of India was debarred from doing exchange business while the Indian Joint Stock Banks have been prevented by other considerations to enter this field. The four main reasons are —

- (a) The competition of well established non-Indian exchange banks with large capital and reserves.
- (b) The absence of branches of Indian banks in London and important foreign centres which precludes them from taking part in arbitrage and direct exchange transactions.
- (c) The small profits now realised from the business.
- (d) The full employment of the resources of the Indian banks in internal business of a more profitable character.

These limitations have prevented the Indian banks from sharing in the foreign exchange business of the country and the Exchange Banks have come to occupy an unassailable position. The Exchange Banks have branches at several important commercial centres of the world and are, therefore, able to finance the export as well as the import trade of the country very easily.

These banks have their head offices located outside India and in fact represent various commercial interest for example, English, Japanese, German, American etc. They fall into two groups (1) Banks doing a considerable portion of their business in India, and (2) banks which are agencies of large banking corporations doing a major portion of their business abroad. In their earlier years, their funds were drawn mostly from London but in recent years they have been attracting an increasing volume of deposits in India. These banks have moreover been led by the lack of general banking facilities to take up also the ordinary internal banking business and at the present time, they have become a very important and powerful element in the general banking system of the country.

"The Exchange Banks are not subject to any legal restrictions in India. They are exempt from all the statutory obligations to which Indian Joint Stock banks are subject. They do not even publish their balance sheets giving the information about their Indian business separately from their

other business. They draw a large part of their capital from Indian deposits; nevertheless the depositors are not protected by any regulations governing the operations of such banks in India. It is, therefore, proposed that foreign banks operating in India should be required to take out licenses under certain conditions for carrying on their business in India. The publication by the Exchange Banks, under statutory regulations of weekly statements showing their assets and liabilities in India is very desirable in the general interests of the country. Some control over the foreign banks is also recommended on broad national grounds. For example, it has been suggested that it may be necessary to restrict the operations of any bank which worked against Indian interests, by, say, refusing to accept policies of Indian Insurance Companies though they were sound, deliberately placing difficulties in the way of Indian traders which were not justified, and by imposing unjustifiable handicaps against their Indian customers. It is also necessary for the safety and stability of Indian banking and in the interests of the Indian money market, that the Exchange Banks should be compelled by law to maintain a fixed minimum proportion of cash balance to their total deposits in India and they should not be allowed to disturb the statutory proportion by events affecting their position outside India. Further, it has been pointed out that these Exchange Banks are able to attract large deposits which they carry away to England and other foreign countries for investment when the foreign trade is slack in India. It has been suggested that some sort of restriction should be placed on foreign banks so that Indian money may be used for Indian requirements."

*Question 9.*—What are the criteria by which you would test the success of the co-operative movement in India.

*Answer.*—The object of establishing co-operative societies was defined as "the encouragement of individual thrift and of mutual co-operation among the members, with a view to utilisation of their combined credit by the aid of their intimate knowledge of one another's views and capacities and of pressure of local public opinion." It was not only to remove the agrarian indebtedness but it was also to be the means of uplifting the agricultural population into an intelligent, thrifty, progressive peasantry. It will be seen that the object of the Co-operative Act was twofold.

On the one hand, it was hoped that the movement would adequately meet the problem of agricultural indebtedness, would remove or wipe out the existing indebtedness, and

prevent further indebtedness. On the other hand, it was thought that the movement would mobilise the scattered savings of the cultivators, would promote thrift, self-help, mutual trust and confidence and would thus enable the cultivator to get cheap credit from the combined resources of his own class for his requirements. How far the co-operative movement has achieved its avowed objects is a question difficult to answer. The movement has not indeed succeeded in curing all the economic and social ills from which the country is suffering to day. It has not been, however, altogether barren of valuable results. It has, for instance, made cheaper credit available to the agricultural and artisan classes through the agency of co-operative societies and much saving in respect of interest paid by the labourers has thus been effected. The co-operative movement has successfully undermined the moneylender's position in the village and in many places his monopoly has been broken. In the matter of debt redemption, much still remains to be done, and it has been doubted whether co-operation of itself would ever be equal to the colossal task of ridding the peasantry entirely of its burden of indebtedness. With the progress of co-operative banking, the hoarding habit has received a check and money that has lain idle and capital that was hitherto inaccessible has come into the hands of the agriculturists. The influx of hoarded wealth has in some cases paid off old debts and redeemed old mortgages. Agriculture has been benefitted in a variety of ways. The movement has promoted the organisation of agriculture on a co-operative basis supplying the various needs of the peasant. Co-operation has made easy the work of the Agricultural Department for popularising improved seed, cattle and implements.

In addition to the economic benefits, co-operation has also brought in its wake certain intellectual and moral advantages to the agriculturists. Self-restraint, punctuality, straight-forwardness, self-respect, discipline, contentment and thrift have been encouraged. In some areas, litigation has markedly decreased. In others, the common funds have been used to start schools, to provide scholarships, to distribute quinine, to provide drinking wells and to clean streets. As Mr Darling says "Litigation and extravagance, drunkenness and gambling are all at a discount in a good co-operative society and in their place will be found industry, self-reliance and straight dealing, education and arbitration societies, thrift, self-help and mutual help."

To quote Mr Wolff remarks "Co-operation brought money to many a spot thirsting for it, replaced insolvency

by solvency, liberated many from the *sowcar's* yoke and awoke many a *mahajan sowcar* to find the fact that their occupation is gone."

No one can deny the intrinsic value of the co-operative movement as a factor in advancement of education, of material prosperity and moral uplift. There is, however, a tendency to exaggerate these advantages. Men like Mr. D. E. Watcha predicted a gloomy future for the co-operative movement in India and warned the country against being duped by a false growth. Writing in the *Indian Journal of Economic* he observed "The indebtedness of the agriculturist is so colossal, while the resources by way of capital of the societies are so extremely limited and hedged in by restrictions and limitations that there never can be any emancipation of the ryot from the slough of indebtedness." He doubted whether co-operative societies slender resources as they possessed would ever manage to wipe off the immense load of agrarian debt which according to the lowest computation was not less than 375 crores of rupees. Considering, therefore the vast agricultural population of the country and the comparatively small number of co-operative societies in existence, the movement at best can be said to be still in its infancy and to have hardly touched even the fringe of the problem. A true spirit of co-operation can hardly be said to exist even among the members of such societies. Many people are drawn into the movement because of its intimate connection with the Government.

There are also many obstacles to the success of the co-operation in India. The ignorance and illiteracy of the rural population, embezzlements of society's funds, the policy of drifting loans, want of self-reliance and increasing dependence upon the Government are factors which have led to the slow progress of the movement in India.

*Question 10* — Describe briefly the method of redeeming public debt.

*Answer* — The following are the principal methods by which the National Debt can be reduced or repaid —

(i) *Application of the surplus annual revenue.* — This is perhaps the simplest method but it is a very slow and inadequate since in some years there may be a deficit, and unless the revenue be arranged to yield a surplus annually, no definite amount can be calculated upon for reduction. It may also be contended that any surplus should be utilized

for the reduction of taxation not for the reduction of the debt

(ii) *Redemption by purchase of stock*—When Government stock is offered on the market at low price, public officials may purchase a certain amount of such stock and cancel it. This method is profitable only when money is available at lower rates than are being paid on Government Stock. The Government is able to redeem stock carrying high rates and thus to reduce net burden of debt. Such operations have to be conducted with considerable care otherwise the prices may be advanced if the state officials show themselves too eager to effect purchases for cancellation.

(iii) *Terminals Annuites*—The principal is the substitution of an annuity for a fixed period in place of a certain amount of permanent debt. By this means, permanent debt is converted into temporary debt. The amount of the annuity is greater than the interest charged on the surrendered stock and thus involves a greater temporary drain over the Treasury during the period of annuity but when the payment ceases a certain amount of debt is completely wiped off. The device is not so popular as in former times and accounts for a very small proportion of the total sum.

(iv) *Sinking Funds*—The general principle of a sinking fund is to provide out of income a certain sum of money so calculated that, invested at compound interest, it will accumulate to the amount required by the time the loan is to be redeemed. This method is very commonly employed by Governments and local authorities for the reduction of their obligations.

(v) *Conversion*—This method involves the conversion of one loan into another bearing a lower rate of interest. Such operations may be made optional or compulsory. Voluntary conversion may take place either when debt actually matures for payment, or, by the voluntary acceptance before the date of maturity of an offer made by the state to its creditors. A conversion scheme may be made compulsory in the case of loans which are repayable at any time by offering holders the alternative of a lower rate or repayment of their holdings. Conversion is not repayment, it is only the exchange of new debts for old. But if the interest on the new debts is less than the interest on the old, the immediate burden of debt is reduced. The gain by reduced interest can be applied towards redemption of the principal.



There are some who maintain that the National Debt cannot be paid off in any of the above manners out of income in a reasonable number of years. They have suggested drastic proposals for the reduction of the burden —

(i) *Repudiation of the debt* — This, apart from its moral aspect, is a case of national bankruptcy both of means and character, it becomes a check to development of trade and is a destruction of national credit for the future, and it is as impolitic as it is dishonest.

(ii) *Forcible reduction of interest* — This method is as unsound, unjust and dishonest and open to similar criticism as the first one. Investors in Government securities would be penalised for the general benefit while the investors in other securities would not be affected. The breaking of contractual obligations would render future borrowings impossible.

(iii) *A capital levy* i.e. the state should impose a levy on capital values, carried out on a progressive basis, with the object of reducing the national debt. The proposal is criticised on the grounds of its grave effects on industry and credit. It is urged that a levy, however, well planned would cause a wholesale realisation of property with the result that values would seriously decline. The effect on credit would, also be serious. The levy would involve a great realisation of securities resulting in a fall of the value of Government Bonds. The levy would discourage saving, drive capital abroad and kill private enterprise.

(iv) *Increased Taxation of Higher Income* — The effects of such a course will be the same as that of a capital levy.

*Question 11.*—Explain the principal features of the Indian Income Tax System. What steps would you take to improve the same?

*Answer* — Prof Brij Naram notices the following distinguishing features of the Indian Income Tax System —

(1) An improvement has been made by substituting the basis of assessment of income for the current year by the basis of income for the previous year but no provision exists under the present system for the setting off of losses against profits of subsequent years. Thus over a certain period of profits and losses, which was taken as a whole may leave the tax-payer with no net income to his credit, he will still be subjected to a tax on his profits calculated without any reference to his losses.

(2) The exemption limit in India is light but no provision is made for allowances in respect of wife, children and dependents. Marriage is universal in India but the tax-bearing capacity of different families with the same income is not the same. It is affected not merely by the number of children and dependents but by the number of boys receiving school or college education.

(3) No differentiation is made between earned and unearned incomes in India. Thus, Indian tax pays no attention to the way in which the individual spends his income, nor does it try to tax the varying abilities arising from variations in the way in which the individual earns his income.

(4) The method of graduation in India is not ideal. Incomes are divided into classes and different rates are charged according to the class to which the income belongs. The graduated rates are not levied on the successive doses of the individual's income but each individual has to pay tax on his entire income at the maximum rate to which it could be subject i.e. if an individual gets an income of Rs. 21,000 he would pay 12 pias in the rupee not merely on the excess of his income over Rs 21 000 but on every rupee of his income. There is thus no correspondence in the movements of the income and the rate, the income rising steadily, and the rate jumping up by fits and starts. The graduation of the Indian Income Tax with its phenomena of jumps conflicts with the principle of ability to pay and this is a fundamental defect of the Indian Income Tax. The curve of progression requires to be made smooth.

NOTE.—The method of levying tax has been since modified. Instead of the step system, slab system has been introduced. Incomes of an individual assessee are now divided into slabs and the rate of tax increases progressively on each slab. The result is that higher the income bigger the tax.

(5) The Income Tax is heavy, no attempt is made in this to discover any one's taxable income as is done in other countries.

(6) There is also the need for extending the allowance for depreciation even to machinery and property not owned by the manufacturer and to the need for granting an allowance for obsolescence to intangible capital such as patents etc.

(7) Corporate income in this country pays the Indian Income Tax proper and also Super tax. So far as Income Tax is concerned it is levied at a maximum rate but the shareholders are entitled to get refunds from Government in case the rate of tax applicable to their total income is below the maximum rate. Super tax is paid at the flat rate of one anna in the rupee on all profits on companies in excess of Rs. 50,000. No refunds are allowed of this tax even though shareholders' total income may fall below the minimum income exempt from the personal tax.

(9) The unregistered firm is an independent institution in the eyes of the Income Tax Department. It is treated like an individual and subjected to both the personal income tax and the personal super tax. Income received by the members of unregistered firm are not included in their personal income. The result is that the poorer partner of an unregistered firm suffers in so far as he pays tax at a rate determined by the income of unregistered firm which may be larger than his own individual income. While for the same reason the rich partner gains. Thus treating unregistered firms as individuals, though they are associations of more than one person, tends to make the income tax on such partnership income regressive. It presses hard on the poorer persons making them pay more than is due, while taxing the richer ones at much less than their real ability as determined by their total income. It is, therefore, necessary that the distinction between registered and unregistered firms be done away.

Indian Income Tax is based on several other similar anomalous principles. It is a curious medley of conflicting provisions which fail to stand the test of modern Income Tax theory and the practice of foreign countries. The system needs to-day a thorough overhaul and the several anomalies and inequalities should be removed as a result thereof.

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## 1937

*Question 1*—Discuss the reasons which lead to the occurrence of Booms and Depressions

*Answer*—The general state of trade varies from time to time. Periods of boom alternate with periods of slump. Prices in general rise and fall and employment increases and decreases. These “panting alternations of the quickened heart” of economic society are known as trade or business cycles or periods of depressions and booms. The trade cycles have occurred in the past with such regularity that trade has been likened to ocean waves and economists refer to its ebb or flow. This cyclical movement of trade is now universally accepted as abnormal, if not inevitable, feature of economic society.

A trade cycle is the most baffling phenomenon of modern times. If its cause or causes could be elucidated, many other economic problems which are still the subject of controversy would be solved. Moreover, the discovery of the causes would facilitate the discovery of neutralizing or modifying agencies to the extent that these were desirable—for it is by no means agreed that the complete elimination of cyclical fluctuations is a desirable end. Trade fluctuations have long attracted the attention of the economists and governments and have been the subject of close attention, but the fact is that a trade cycle still remains the greatest of the many unsolved problems of economics. The following are the chief attempts at explanation—

1. *Climatic Theory*—It is maintained by some economists that climatic conditions determine the abundance or scarcity of the harvests and upon these largely depend industrial conditions throughout the world. The failure or abundance of the harvests of important crops touches the position of the agricultural communities affecting not only their economic well-being but also their power to purchase the goods of other countries. Thus, are the effects, adverse are favourable, felt throughout the trading community. The failure of India's grain crop influences very much British industries.

The explanation of the trade cycle which lays special or exclusive stress on climatic variations is commonly known as the Sun-Spot Theory enunciated by W S Jevons who held that the periodic recurrence of crisis is to be explained by the recurrence of Sun-Spots at almost regular intervals. Sun Spots

affect the weather in all parts of the earth and influence the production and prices of corn and other things and bring about crisis. Jevon's theory is now discredited.

2 *The Competition Theory or the Excess Credit and Over production Theory*—Some economists hold the view that trade cycles are due almost exclusively to competition between independent producers. It is maintained that under competition there must normally be a tendency to over-production. When trade is improving, there is an inflow of money into productive enterprises and an expansion of credit facilities followed by a rise in prices and an attraction of new producers into the industry. In the absence of any co-ordination between the producers, the continued extension of production overtakes demand for the products. The result is a fall in prices. This leads to a restriction in production, firms near the margin disappear, banks call in their credits, prices fall still further and for a time there is a general depression. After a while, it is found that too little is being produced to meet the demand. The scarcity of goods sends prices up again; production revives, and so with the improvement in trade the whole cycle is completed.

"Monetary theories are criticised mainly on the grounds that the fundamental causes of fluctuations arise out of the conditions of industry itself rather than finance, and that although monetary influences are important, they are not the primary cause of fluctuations. Credit and currency inflation make a boom possible and condition the extent of the boom, but they do not cause it. A more important objection is that the trade cycle, being a world phenomenon, cannot, on the one hand, be attributed to the internal conditions of one or two countries, nor, on the other hand, can it be remedied by isolated attempts at monetary reform. International and not national action is clearly necessary if international stability is to be achieved."

3. *The Oversaving or Under-Consumption Theory*—This is also called the Over-capitalisation Theory and has been developed by J. A. Hobson. In his opinion, there exists a limited market for most commodities and this he offers as an explanation of the tendency of production to outrun consumption. He contends that there is a normal tendency for an excessive proportion of the general income of the community to be saved and applied to capital purposes instead of consumers' goods. Over-saving involves under-consumption. The markets are glutted with unsold products.

and the result is that there is a fall in prices followed by depression in trade

This theory offers a partial explanation of the prevalence of depression but it is not adequate as an explanation of periodicity

4. *The Psychological Theory*—Economists rightly lay great stress on the psychological factors in crisis. It is the doctrine that people incessantly and insensibly would know one another's ideas and influence one another's minds when they are repeatedly brought into contact as inter-related parts of a system. A market is a crowd and has the psychological characteristic of the crowd that the general opinion imposes itself on individual members with extraordinary force and rapidity. When trade is good, people are optimistic, they buy more and prices rise, production is stimulated. Conversely when trade is bad people are pessimistic, they stop buying, prices fall and production is checked.

The psychological factor undoubtedly contains much truth which no other explanation can afford to ignore. It does not, however, satisfactorily explain the approximate fixity in the period of the trade cycle nor the difference between the wants of consumers in good and bad times.

*Question 2*—Distinguish between the various forms of the Gold Standard bringing out their respective merits and drawbacks.

*Answer*—The Gold Standard is so called because under it gold is the measure of goods, services and all debts in the last resort are payable in gold. Thus, when a country is on the Gold Standard its currency unit is gold itself and circulates in the form of full-bodied gold coins, or represents a fixed quantity of gold. The value of the currency under it varies with that of gold. There are several ways of making the currency unit of a country represent a fixed quantity of gold and, therefore, as many variants of the Gold Standard.

(1) *Gold Currency Standard*.—Under a Gold Currency Standard, full-bodied gold coins remain in active circulation. They represent the final standard of value, paper money and other money media in common use are redeemable in them. The value of the money unit would be identical with that of the gold content of the coin. At the same time, free coinage of gold, free melting of gold coins, free export and import of gold is allowed. The Central Banking Institution of the

country is compelled by law to purchase and sell gold at a fixed invariable price.

(2) *Gold Bullion Standard*.—Under this system gold coins need not and usually do not form a part of the monetary circulation and the currency needs are met by paper money and token coins but all legal tender currency is freely convertible into gold (not in the form of coins but of bars) at a fixed rate. Gold is similarly convertible into legal tender currency and export and import of gold are unrestricted as under the Gold Currency Standard. The Central Bank is compelled to buy and sell gold in bulk at prices fixed by law.

(3) *Gold Exchange Standard*.—The essentials of this system is the provision of a cheap internal currency of silver or paper and the maintenance of the value of that currency as near as practicable to a fixed part with gold (or with the gold currency unit of another currency) by control of the exchanges. This necessitates the possession by the State either of adequate reserve of gold or of its equivalent in the form of gold exchange *i.e.* saleable exchange on one or some of the chief Gold Standard countries. If gold reserves are maintained they are kept generally in the foreign centre whose currency unit is taken as a basis.

This currency system has proved especially suitable to those countries which desire to regulate their external exchanges as far as possible on a gold basis but which are unable to adopt a full Gold Standard for internal use, either because of the comparative poverty of their inhabitants or because their resources are very meagre. It is not the best monetary system and has certain inherent defects. The system requires a good deal of management on the part of the Government, it is incapable of achieving an automatic expansion and contraction of currency, it is far from being simple and intelligible to the masses, and it involves the maintenance of reserves in a foreign country liable to the risks arising through any political or economic difficulties in that country.

Gold Bullion Standard is an advance upon the Gold Exchange Standard. It is a Gold Standard without a gold currency and possesses to a large degree all those advantages which are claimed for a Gold Currency Standard. Until recently, most countries of the world had their currency system based on the model of the full Gold Standard but the force of necessity during the 'War' as well as advance in economic thought have now made people realise that actual gold coins

passing from hand to hand are all unnecessary luxury and a country can have all the essentials of a Gold Standard without gold coins by adopting any of the other arrangements described above viz, Gold Bullion Standard or Gold Exchange Standard. The Gold Exchange Standard is, however, looked upon with a certain amount of suspicion but the Gold Bullion Standard has come to be regarded as the most suitable alternative to the orthodox type (Gold Currency Standard). The Gold Bullion Standard is, however, devoid of simplicity and intelligibility which are indispensable requisites of a sound currency system. The Gold Standard in spite of its expensiveness and inconvenience the most satisfactory and the least risky system of all and its principal merit is its simplicity and the protection it affords against the evil of inflation.

*Question 3* — Explain the recommendations of the Hilton Young Commission regarding the position of the rupee in our currency system.

*Answer* — The Gold Standard was restored in Great Britain in May 1925 and on August 25 in the same year was appointed the Hilton Young Commission to report on the Indian Exchange and Currency System and practice.

The Commission's labours occupied about a year and it submitted its report in July 1926 by which time the 1s 6½ gold rate had been effective for about a year as a result of the deflationary policy pursued by the Government.

The majority of the Commission, as was anticipated, recommended stabilisation at this rate mainly on the ground that price had preponderantly adjusted themselves to this rate and that so far as wages were concerned "considerable progress had been made in the process of adjustment." Indians knew that the techniques of first making the rupee scarce, forcing up the exchange value thereby and then appointing a commission to get its approval in favour of the *fait accompli* had been practised too often. There was only one independent Indian member on the Commission, viz, Sir Purshotamdas Thakurdas. He strongly dissented from the recommendation of the majority. He exposed the hollowness of the arguments employed by the majority and contended that it was dangerous in the interest of India to fix exchange so high when economic adjustment to the rate recommended was far from complete and when there were actual apprehensions in well-informed circles of a fall in gold prices. "Insistence on stabilisation at 1s. 6½", he wrote, "will not only produce, but will prolong the profound disturbance of economic conditions throughout



India which is just beginning to be perceived, and the worst effects of which are still to come"—words which had almost a prophetic ring about them. A similar warning had been given by Mr. Dalal when opposing the 2s. gold rate. He had said "The probabilities are that with the higher sterling cost of the rupee the demand for Indian produce will fall off, while remittances from India being cheaper in rupees, imports will be stimulated. If these probabilities should materialise, India's trade balances will become less favourable to her than they have been or it may be the trade balances will turn against her." The rulers paid heed to neither of the two warnings though, unfortunately, both turned out to be true to the letter.

The Hilton Young Commission had made a number of other recommendations with a view to the switch-over now to a gold bullion standard and the establishment of a Reserve Bank to be vested with the control of both currency and credit. Government decided to tackle the question of the ratio first and accordingly in 1927 they introduced a Bill in the Assembly as an interim measure providing for stabilisation at 1s 6d. This caused a terrific storm throughout the country the echoes of which have not yet died out. In the Assembly, Government carried their point by the very narrow majority of 3 votes—68 against 65. The minority consisted of non-officials. The majority consisted almost wholly of the nominated element including the official bloc. No other issue debated in the Assembly has perhaps aroused public interest in the same degree nor can one recall another occasion on which canvassing for votes on the official side was characterised by the same methods as on this.

The course of events after the fateful decision on the issue was a confirmation of the worst fears of Government's critics. With the exception of 1928, exchange remained persistently weak and in maintaining it Government dissipated India's gold and silver assets, added to her unproductive debt dealt a stunning blow to her trade and industry, brought the country's credit to the verge of collapse and aggravated the distress which the Depression was to bring in its train. Deficit budgets with increased taxation became a normal feature.

*Question 4*—Explain the functions of a Central Bank. To what extent does the Reserve Bank of India fulfil these functions.

*Answer*.—See answer to Question No. 5, Economics [1945.

*Question 5* --What is meant by the statement "that the Indian money market is of a sectional character and lacks unity?" How far is the Reserve Bank of India adequately equipped to remedy this defect?

*Answer* --The statement means that the Indian money market is loosely knit organisation, there being no link between the constituent members. Each sectional agency of the money market organisation limits itself to a particular class of business and virtually remains independent in its own sphere. The Imperial Bank of India, the foreign immigrant banks, the India Joint Stock Banks, the Co-operative Banks and the indigenous bankers—who form the money market—have all carved out for themselves respective spheres of their own. There is very weak co-relation between the operation of these credit agencies. No system of enlightened Co-operation or intelligent co-ordination exists between the Imperial Bank and the indigenous bankers, between the Imperial Bank and the Exchange Banks, between the Exchange Banks and the India Joint Stock Banks, between the Co-operative Banks and the other credit agencies. These different credit agencies work severally and not collectively with the result that there has been no development of a co-ordinated credit policy. This has led to an inelastic system of credit which cannot expand or contract in accordance with the requirements of the country. Besides, there are two kinds of money markets in India. The indigenous money market and European money market and there is no effective liaison between the two. This state of affairs has been brought about by the absence of a central banking authority to control credit and currency which are in the hands of two different authorities in India each working without any regard of the other.

The proper mechanism for securing an elastic currency is a Central Bank which by granting loans or creating credit instruments of short duration can meet the seasonal demand for money and when the demand slackens can automatically cancel the instrument or loans.

Due to the absence of this mechanism in India, there was no unity in the money market and the rate of discount showed considerable variations. The Reserve Bank of India has provided a missing link in the chain of banking organisation, and through its dominant position, exercises great control over all the other credit institutions. It will have sole monopoly of note issue, and thus the divorce between credit and currency which so far was the subject of adverse

criticism would end. Besides, the Government's operation in the money market have been taken over by the Reserve Bank which will now operate more with a view to maintain the stability of the market rather than satisfy the interest of the Government.

*Question 6.*—Why do prices rise and fall? Show how the instability of prices affects the economic conditions of the several sections of the community. Give Indian Examples.

*Answer.*—Supply and demand are the two predominant factors which govern the fluctuations in the market price of commodities. If the supply of a commodity is increased other things remaining the same (that is no change in demand) prices will fall down *vice versa*. If the demand for a commodity is increased, other things remaining the same (i.e., there is no change in supply), the price will go up and *vice versa*. Changes in the demand for and supply of a thing may arise from various causes. The various changes in the arts of production, the alternation of good and bad harvests, failure of crops, the discovery or expansion of mines affect the supply while changes in the fashion of dress, of houses and furniture, an increase or decrease in the wealth or means of people, changes in the utility assigned to a thing, extension or contraction in the use of substitutes affect the demand.

2. An increase or decrease in the quantity of money in circulation also affects prices in an inverse proportion. An increase in the quantity of money (other things remaining equal) tends to raise prices while a decrease in the quantity of money (other things remaining the same) tends to lower prices.

3. The development of banking and credit system and the inflation of currency have the same effect on prices as the increase in the volume of currency. If there is an increase in the use of credit the prices of commodities will be affected. The rise in price is also brought about by the inflation of currency.

4. The rise in prices may sometimes be caused by an increase in the rapidity of circulation of money. This rapidity is often due to the increased facilities of banking.

All men are interested more or less in the variations occurring in the prices of commodities. Most of the members of a community are either debtors or creditors, some are producers or businessmen, some are labourers earning daily wages while many are persons with fixed incomes such as salaried men, annuitants, etc. All these different sets of people are consumers and are affected in one way or the other by change in the price of commodities.

FALLING PRICES	RISING PRICES.	STEADY PRICES.
<p>Are beneficial to people whose incomes do not fall at the same rate, <i>e.g.</i> fixed interest stockholders, employees and others whose income is governed partly in contract or custom</p> <p>Creditors for specific sums benefit as money appreciates in purchasing value</p>	<p>Are beneficial to manufacturers and others whose products rise in price faster than the expenses of production. They may also have a useful psychological effect in stimulating and economic undertakings, provided that they do not lead to injurious speculation</p>	<p>Are beneficial to traders and industrialists in general, especially over a long period. They enable forecasts to be more accurately made and thus, facilitate long period contracts. Consequently, production and employment are rendered more continuous with a more regular incomes for employers and workers as a whole</p>
<p>Are a matter of indifference to those whose income vary in the same proportions, <i>e.g.</i> wage earners on a satisfactory cost of living sliding scale, provided that they still retain their employment</p>	<p>Debtors for specific sums benefit as money depreciates in purchasing value</p> <p>Are a matter of indifference to those whose expenses and incomes in the same proportion</p>	<p>While the benefits of either falling or rising prices are to a large extent offset by counter forces, those of stable prices are more enduring</p>
<p>Are harmful in so far as they mean falling net receipts and cause restriction of business activity</p> <p>Debtors are adversely affected</p>	<p>Are harmful to those whose incomes do not rise at the same rate</p> <p>Creditors are adversely affected</p>	

*Question 7.*—Discuss the economic role of the Stock Exchange, and point out the abuses to which it is liable

*Answer*—The Stock Exchange performs an essential function by providing a market for capital which is already invested. It facilitates the transfer and arrangement of that capital and is the means whereby capital represented by stocks and shares may be graded and realised easily and cheaply. It renders possible international dealings in most kinds of securities and makes shares and stocks acceptable as cover for loans. The rigidity of the rules governing the market and also the high standard of commercial morality which prevails, create confidence and bring great number of peoples into business relationship. The result is that the tremor of business on the stock market has important repercussive effects throughout the community. The Stock Exchange itself is not a market for new capital but the advantages which it offers, particularly that of ready realisability, are important in stimulating and encouraging the flow of new capital for industrial and other purposes. The stock and share market is to-day a vital factor in the economic organisation of every progressive country and can substantially further industrial expansion by the facilities it can offer for financing industries.

Dealings on the Stock Exchange are not, however, only for investment purposes. There are some which are merely speculative in character. Speculation again is legitimate and illegitimate. The latter form of speculation is highly harmful and brings ruin to many. Thus the Stock Exchange, organised as it is, has encouraged illegitimate speculation with attendant abuses and risks. Stock Exchange has caused ruin of many under other circumstances also. We know that as a result of the conditions created by the War many companies were floated, their shares were often over-subscribed and the values of the shares of the existing companies went up. In the period of inflation, a large number of people engaged in other occupations were attracted to the Stock Exchange in the belief that fortunes could be easily made when the turn in the time came. Many of the newly floated companies did not meet with success and went into liquidation. There were big failures of companies which resulted in a loss of crores of rupees.

*Question 8*—Examine the principle on which the policy of discriminating protection in India has been based.

*Answer*—See answer to Question 'No 7, Economics 1941.

*Question 9* --Why do countries enter into Commercial Treaties ? Mention such a treaty made by India in recent times, and discuss its significance

*Answer*—Commercial treaties may be entered into between two nations, whereby it is agreed to admit on favourable terms certain commodities produced in the contracting states. Favourable treatment to a country's exports can thus be and is secured by means of commercial agreements with foreign nations. Reciprocity and "Fair trade" are established as a result of such treaties and international jealous attacks and reprisals are thus avoided. International understanding and treaties are, therefore, an important advance over crude attempts to penalize and to retaliate upon foreign industries.

The general scope of trade agreements is well expressed by Calvo in his work of international law. Trade agreements generally provide for the importation, exportation, transit, transshipment and bonding of merchandise, [customs tariff navigation charges, guarantee the admission of vessels into each other's ports, coasting trade, fishing rights, the admission of consuls and their rights, the local status of the subjects of each country in the other in regard to residence, travel, ownership of property, payments of taxes or exemptions and military service. Such trade agreements may also include questions of transport. Although the scope of trade agreements is thus very wide, almost all the modern trade agreements are concerned primarily with the regulation of tariffs. The general form of modern trade agreements is much the same embodying mutual concessions but the elaborateness and complexity of the agreements depend upon the nature of the agreements and the status of the contracting parties. Trade Agreements are either bilateral extending to two countries or multilateral embodying concessions granted to more than one country.

In recent years India has entered into many commercial treaties with other countries and the most important of them are the following —

- (a) Indo-Japanese Trade Agreement (1934)
- (b) The Bombay-Lancashire Textile Agreement (1933)
- (c) The Indo-British Trade Agreement (1935).

*Question IV* —Distinguish between —

- (a) Revenue duties,
- (b) Protective duties,
- (c) Preferential duties,
- (d) Anti-dumping duties

Give illustrations from Indian conditions

*Answer* — (a) *Revenue duties* are taxes imposed by a country upon foreign commodities for the purpose of getting a revenue but such taxes are not intended to protect domestic industries.

(b) *Protective duties*, on the other hand, are levied for the protection and fostering of home industries. The avowed object is the imposition of duties upon imports not for the purpose of realising a revenue from the admission of foreign articles, but with the aim of excluding them from the country and thereby giving a preference to home products which are at some economic disadvantage in comparison with foreign articles. Duty on silver is a revenue duty in India while the tax levied on imported sugar is a Protective duty.

(c) *Preferential duties* are duty, taxes levied on imports of a preferred country and are lower than those imposed on the products of other foreign countries. The object of such duties is to give a preference to the products of the "preferred" country by imposing heavy duties on foreign produce with the object of diverting the trade to the "preferred" country. These duties are collected under the "Most Favoured Nations" agreements and other commercial treaties. Taxes on British goods are lower than those charged on German goods and the former, therefore, fall within the purview of preferential duties.

(d) *Anti-dumping duties* refer to taxes imposed by a country upon the imports which are being "dumped" into its market by another country. Dumped goods disturb the industries of the country into which they are dumped and such a country would be justified in preventing its industries being crushed by the unfair competition of dumped goods.

*Question II.*—Discuss the organisation and present position of one of the following industries in India. —

- (a) The Steel Industry,
- (b) The Cement Industry,
- (c) The Jute Industry.

*Answer —(a) See answer to Question No. 8 Economics, 1940*

(b) *The Cement Industry* —The manufacture of Portland Cement commenced in Madras as long as 1904, but it was not until 1912 that the foundation of the present industry was laid. In this year, the Indian Cement Coy. Limited was formed and was followed in the two succeeding years, by two other companies—Katni and Bundi. At their inception, all these factories were small but they endeavoured to meet India's Cement requirements during the War period to the best of their ability and within the means at their disposal. In the post-war boom period, several new Companies were formed. The three old companies increased their capacity. Thus the development of the industry was rapid after the war and the aggregate production increased from 1945 tons in 1914 to 236,746 tons in 1924. The imports fell down considerably and showed a decrease from 165,733 tons to 124,186 tons during the same period. The year 1924 saw the industry in a parlous state. Most of the new factories had been erected within the geographical marketing areas of the existing works and internal competition set up a scramble for business at any price for delivery over any distance, with the result that profits of the company fell down and the shareholders in the industry suffered heavy losses. This state of affairs could not, of course, go on and in 1924 the claim of the industry for protection was referred to the Tariff Board. The Board declined to recommend protection to the industry on the ground that it was suffering from over production and prices were determined by internal competition amongst India's manufactures and not by the imports. The declination of the Government to grant protection to the industries made the manufacturing companies to feel the necessity for co-operation among themselves. The persons responsible for the management of such companies accordingly formed a pool known as the Indian Cement Manufacturers' Association. The industry now began to revive. Selling prices were stabilised and the first step was taken in the development of markets for the excessive output. Along these lines the industry progressed until 1930 when the manufacturers realising the value of co-operation formed the Cement Marketing Company of India Limited. Under this company, the selling arrangement of the member companies were centralised and its charter was to ensure that each member Company received a proportionate share or quota of the total business according to its rated output capacity. During the six years the Cement Marketing Company has been in existence it has been successful to the extent that it has provided each works



with an off-take in accordance with the prearranged quota with amalgamated funds. It has also been able to devote much attention to effective advertising and propaganda for the betterment of the sale. The progress of the Indian Cement Industry has been facilitated by the establishment of the Marketing Company. The imports of foreign cement have considerably fallen down and amounted 67,000 tons in 1934-35. In the same years, the total production of Portland Cement in India amounted to 764,000 tons as compared with 236,746 tons in 1924. The quality of Indian Cement is not inferior to that of the British production.

Unfortunately for the company, the possibility of sales was not uniform throughout the country and herein lay the main limitation in its charter. Under the present system, the factory or factories though being situated in the heart of the consuming areas, were not allowed to supply to full capacity and Cement Factories situated at great distance had to send their products to these areas. The waste which resulted by this course can be well realised. The Companies engaged in the manufacture of cement realised in the defect in the cement marketing and the latest step which they have taken to eliminate waste and to strengthen their positions is the Merger. The scheme was intended to rectify the existing defects, to bring about additional advantages and to consolidate the industry in a permanent form. According to the Merger scheme, a company by name the Associated Cement Company of India has been formed. The shares of the member Companies have been converted into the shares of the new company. Ten companies have agreed to join the Merger. According to the new scheme, the evils of the quota system, abovementioned will be eliminated. The quota system is dispensed with and there will be territorial market by which manufacturers whose producing capacity is unable to meet local demands will be equipped with additional machinery. Thus freight and wastage will be avoided. The Cement Marketing Company will assume the responsibility for selling the products of the various manufacturers.

The Industry was again affected when, in 1938, the Dalmia Group of Companies which came into being competed with the Associated Cement Companies. Happily, this state of affairs did not last long, and by the end of 1940, an agreement was concluded between the two major groups to market their output through a central organisation.

The Cement Marketing Co of India, Ltd, was again brought into operation. Prices were reduced further and thereafter stabilised at an economical level restoring the industry again to a healthy footing.

The Cement Marketing Company then controlled and managed the sales and distribution of all the cement manufactured by the Associated Cement Cos, and the Dalmia Group of Companies, the former having 12 factories in operation and the latter five factories. The output of all these factories represented about 85% of the whole industry as there were four other cement companies operating independently.

*Effects of War*—As in other Industries, so also in cement, the recent War has had many effects. With the rise in the cost of all materials required for the manufacture and packing of cement, production cost naturally increased. To off-set this, in part, the price of cement had to be raised but it was still maintained at a very reasonable level, the rate being controlled by the Industries and Civil Supplies Department. Even with the increase allowed by the Government after prolonged examination, the price of cement compares very favourably with the price of other building materials as most of them have gone up by over 200 to 400 per cent.

Just before and for some time after the outbreak of hostilities, the demand from export markets both for Government and public use began to develop and India eventually became the supply centre of cement to the Middle and Far East. The internal demand similarly increased. Practically 80% of the total output was taken by Government and the balance was strictly rationed for essential repairs. With the cessation of hostilities, the proportion of Government demand fell, considerably but the total demand both of the Government as well as the public has increased enormously.

The two groups separated by mutual consent with effect from March 1948 and they market their output independently.

*Benefits.*—The part which the cement industry plays in the welfare of the country may not be generally appreciated. Not only does it afford employment to thousands of men in the factories alone but also it is one of the largest consumers of Indian coal. The jute industry is also benefited because

over 40 million jute bags are used annually for packing purposes. Then, there is the large freight revenue accruing to the Railway by the transport of coal, gunny bags and cement estimated at some crores per annum

The progress which has been made largely due to the energy and enterprise of the Cement Marketing Company and the Concrete Association of India in educating the country in the uses of cement. Branch offices are maintained throughout India with a staff of over 60 engineers, overseers and skilled masons who give technical assistance to cement users.

That the cement industry is working on the right lines and with an eye to the future, there is no doubt. They are spending a large amount annually on educational propaganda which will be repaid by increased sales, a matter of vital importance.

*Future Development* —With the return of peace, the cement industry has retained its national importance in the sense that it is one of the few commodities that can enter into every one of the main schemes of national programme, viz, communications, irrigation and agricultural development generally and proper housing of the working classes. The cement industry owing to the urgency of demand placed on it in the immediate post-war years and the orderly planning of future development has received due consideration from the Government. The industry has already a programme of expansion, with years of investigation and preparation behind it which will ensure its being fully utilised in the post-war years. Its plant, technical, personnel, financial resources and vast All-India sales organisation—all afford an assurance, of its maintaining an important position in the country today and the continuance of its policy to make available to the public the highest quality of cement at the lowest possible price

(c) *India Jute Industry* —Jute, the golden fibre, is India's greatest contribution to world trade. The growing of jute provides the agricultural population of East Bengal (now mainly part of Pakistan) with an annual income averaging Rs. 44 crores, or about a half of their money income in normal years. As an export product it has, perhaps, no equal, considering that raw and manufactured jute has consistently represented by value about 25% of (undivided) India's outgoing merchandise trade. It has been truly stated that, as the world's foremost packing fabric, jute is prac-

tically omnipresent in world's commerce. The special characteristics of the jute is fibre make it an ideal packing material for sugar, coffee, cocoa, cotton and wool, and a variety of textile products, including cordage, roofing felts and even decorative fabrics.

*Progress of Industry.*—The record of the jute industry may well be said to be one of uninterrupted progress. According to the latest available statistics (that is, those for the year ended 31st Dec 1947), the total number of mills in the Indian Union is 113 and their aggregate loomage 68,547. The total number of mill companies in the I J M A in the Bengal area are 69, and outside the Bengal area 6. The total number of mill companies outside the I J M A in the Bengal area are 3, outside the Bengal area 7. The grand total of the mill companies is 85. The number of mills in the I J M A in the Bengal area are 97, and outside the Bengal area 6. The total number of mills outside the I J M A in the Bengal area are 3, and outside the Bengal area 7. The grand total of all the mills is 113. The number of looms in the I J M A in the Bengal area are 63,826 and outside the Bengal area 1,711. The total number of looms outside the I J M A in the Bengal area are 1,531, and outside the Bengal area 1,479. The grand total of all the looms is 68,547.

*Conditions of Trade.*—The demand for jute goods has been fitful and changing. It depends upon the quantum of international trade. During the first world war, in spite of controls, the industry made abnormal profits, part of which were used for increasing the productive capacity of the industry by adding more looms and spindles. Unfortunately in the inter-war period owing to economic nationalism and restriction in international trade, the demand for jute and jute goods declined very considerably. The Indian mills applied the self-denying ordinance and introduced a restriction scheme in 1921 which continued upto 1929. According to this scheme the weekly hours of work were reduced from 60 to 54. But advantage of this sacrifice was taken by foreign interests which added new machineries and improved their productive power. Hardly had the industry decided to revert to full complement in 1929 when the economic blizzard swept the world. During these years (1929-33) the jute grower suffered more than the jute manufacturer. An agreement was entered into between the member mills and the non-member mills in 1932 after protracted negotiations which continued to work upto 1936. The Government of Bengal restricted the hours of work in 1938 and member mills entered into a voluntary agreement in July 1939.

With the outbreak of the second World War huge orders were placed by the United Kingdom, France the U, S A and India for jute manufactures but it did not give steady work to the industry. For a few months the demand was continuous but it fell in the beginning of 1940 and towards the middle of the year difficulties of shipping became rather serious. Detailed figures for the export of jute manufactures are given below :—

Year.	Cloth (in thousands of yds).			Bags (in thousands of units)		
	Burlap.	Sacking	Total	Burlap.	Sacking	Total
1938	1,967,466	1,459,391	3,426,857	135,724	620,961	756,686
1939	1,893,971	1,406,637	3,300,608	574,898	593,415	1,168,313
1940	2,083,415	1,354,462	3,437,877	586,510	563,279	1,149,789
1941	2,038,578	1,719,083	3,757,661	311,361	526,048	837,409
1942	1,812,000	1,463,000	3,275,000	148,504	537,690	686,194
1943	1,411,000	1,349,000	2,760,000	51,195	511,686	562,881
1944	1,513,123	1,388,938	2,902,061	80,879	380,450	461,329
1949	1,014,551	n a.	n a.	49,814	316,245	366,059
(9 mths)						

*Problems of the Industry*—The problems facing the industry in the transition period are with regard to the adjustment of supply to demand. The productive capacity of the industry was increased after 1918 and the existence of this surplus productive capacity is not justified by economic trends. It is therefore a dead weight on the industry. It is, therefore, suggested that obsolete plants should be scrapped off and any new mills must not be set up any more unless the demand springs up. The industry must be rationalised. It should not be permitted to work with fits and starts as it has been doing in the past. The right course is to shift capital and enterprise from the industry to some other industrial channel where they can be more usefully employed.

In the race of self-sufficiency every country is trying to find substitutes for Jute-paper, siral grass, hemp and flax are some of the new fibres used as substitutes. It is, therefore, that new uses should be discovered for the jute fibre on which the whole economy of Bengal hinges. Jute has already begun to be used for insulating materials, for roofing and for the productives of sheeting for internal and external walls.

Another problem that should engage the attention of the Government is to protect the jute growers. He is poor, illiterate and unorganised. He has hardly any knowledge of the markets and the marketing processes. Co-operative Societies for marketing jute on lines similar to cotton marketing societies in Bombay should be formed to help the growers. Attention should also be paid to the growing of more rice on the land that was formerly devoted to jute.

The last but by no means the least important problem for the jute industry is the regulation of the "futures" market in jute. It is highly disorganised and full of evil practices.

*Effects of Partition*—The partition on 15th August, 1947, of India into the two dominions of India and Pakistan split up the jute industry and the jute growing areas. The manufacturing centres were cut off from their sources of raw material. This has meant difficulties both for the jute cultivators and the burlap industry, which has been responsible for a large part of India's foreign exchange resources.

The following table gives the relative position of the two dominions in regard to jute acreage and production .—

	India	Pakistan
Acreage	29%	71%
Production	28%	72%

It is clear that the Indian Union is the biggest consumer of new jute while Pakistan is the biggest supplier. In other words the prosperity of the grower of jute in East Bengal is dependent on the prosperity of the Indian Jute industry.

It is expected that Pakistan will set up some mills in her territory. This will make our productive capacity still more redundant.

## 1938

*Question 1*—How would you measure the change in the general level of prices Give illustrations.

*Answer*—It is easy to measure changes in the price of any one commodity, but to measure changes in the prices of commodities taken together is not so simple, and economists have to make use of a special mechanism which is known as the index number.

The index number of prices is a measure of the changes which have taken place in the general level of prices as from a given year. This starting point from which the changes are measured is known as the base year. A number of commodities are selected the choice depending upon the purpose for which the index number is compiled and the price of each is equated to 100. It is also usual to assign a weight to each commodity, the "weight" being an indication of its importance in general consumption, otherwise, a large rise in the price of a commodity but little used in consumption may have an undue influence on the general index. The index number of prices for the base year would be 100. Supposing one wants to measure the changes in the general level of prices after a period of five years, the prices of the same commodities in the fifth year from the base year are collected, and the percentage which each bears to the corresponding price in the base year is calculated. This percentage figure for each commodity is then multiplied by its appropriate weight, and the results are added up and divided by the sum total of the weights. The quotient gives the percentage which the general level of prices in the fifth year bears to that in the base year, and the difference between the two measures the change in the general level of prices.

The foregoing remarks can be better explained by an illustration. Suppose that the prices of rice, wheat, and sugar were Rs 1-0-0, 1-8-0 and 4-0-0 respectively in 1931 and Rs 0-12-0, 1-0-0 and 2-0-0 respectively in 1936. Suppose further that rice, wheat and sugar were given the weights of 8, 3 and 1 respectively. The change in the general level of prices would then be 29 per cent as seen from the following calculations.—



Commodity	1931				1936				% o change in '36 as com- pared with 1931
	Price per unit.	Index.	Weight	Weighted index	Price per unit	Index	Weight.	Weighted index	
	Rs a p				Rs. a p.				
Rice	1-0-0	100	8	800	0-12-0	75	8	600	
Wheat	1-8-0	100	3	300	1- 0-0	66	3	198	
Sugar	4-0-0	100	1	100	2- 0-0	50	1	50	
General level of prices	...	100	..	100	..	64	...	71	29

The figures in column (7) represent what is called the simple or unweighted index number as against the weighted index numbers shown in column (9). The latter is considered to be a more accurate measure of changes in the general level of prices.

**Question 2** — In what manner can the banking [system of a country help in getting it out of a depression ?

**Answer** — Banking is an essential economic activity of human society and no country can ever hope to attain economic salvation unless its banking institutions are properly organised and are capable of helping it in times of financial difficulties. Banks can do a lot in assisting a country to get out of depression. When trade collapses the banks have a higher responsibility placed upon them and an appropriate action on their part is a matter of profound concern. Loss of confidence at a time of trade collapse may create an excessive demand for cash. If cash cannot be found, several firms, otherwise quite solvent, share the fate of weaker firms. At such a time it is desirable that a banker should lend freely when undoubted security is offered to them but at a high rate of interest so as to economise the use of the cash available by discouraging those who do not pressingly need assistance. Many years ago bankers were apt to lose their nerve when trade collapsed and seek a deceptive security in a refusal to grant accommodation. The result was almost invariably a panic, the path of which was strewn with bankruptcies, or a crisis. In the losses connected with the bankruptcies the banks shared. But banks now act more tactfully.

and crisis has become a rare occurrence. The careful regulation by modern banks of credit granted to industry and commerce tends to check recurrence of crisis.

The banks by lending freely to producers stimulate production, giving more employment and creating more purchasing power of people. The result inevitable leads to the mitigation of the harmful effects of the depression.

The Central Bank of a country equipped with the power of conducting open-market operations, as the Reserve Bank of India, can expand currency and credit and put additional funds into the market enabling the latter to provide the producers with capital to carry on their productive efforts.

We thus see that the whole economy of an advanced country is bound up with its banking system. Only a fraction of the business of the world is now done without recourse to banker's advances. This being so, the stability of banks and their prudent management are essential to a country's prosperity.

*Question 3* — Explain the circumstances which led to the closing of the Indian mints in 1893. Discuss the effects of the same.

*Answer* — In 1835 a monometallic silver currency was introduced under this system the silver coin was a standard coin inasmuch as its face value represented its bullion value. Mints were open to the free coinage of silver and any person could bring bullion to the mint and get it converted into coins. The value of the rupee was, therefore, dependent upon the demand and supply of the metal.

This system of currency worked well till 1875 when a change came upon the demand and supply of silver increased very much on account of the discovery of new silver mines. Further several European countries viz., Germany, Sweden, Norway and Denmark began to demonetise silver. At this critical moment the United States of America decided to repeal the Sherman Act under which the Government was required to purchase 54 million ounces of silver for annual coinage. For these reasons there appeared a gradual fall in the gold value of silver. The effect of the fall in the gold value of silver was felt by India more acutely than any other country. With the fall in the gold value of silver the exchange value of the rupee began to decline; for the importers of Indian commodities abroad could now pay their debts with silver and the consequence was a steady flow of

silver into India. Between 1874 and 1880 the gold value of silver fell from 59½d. to 51½d. The Indian rate of exchange during the same period fell from 22 3d to 19 9d. This depreciation in the value of the rupee produced an embarrassing situation in India. In the first place, India's foreign trade was unsettled. Every fall in the value of the rupee encouraged exports and diminished imports. Secondly, the finances of Government were unsettled. As Government had to remit Home Charges which were payable in gold, all calculations in the budget regarding payments for Home Charges were upset by the fall in the value of the rupee and heavier taxation in rupees had to be resorted to for covering the budget deficits. In the words of Sir David Barbour, "Indian finance in the eighties was a gamble in rains and exchange."

The problem which confronted the Government at this time was how to arrest the fall in the exchange value of the rupee. A committee known as the Herschel Committee was appointed so that it might make recommendation concerning the reform that should be introduced in the currency system of India. The committee suggested that the mints should be closed to the public for free coinage of silver but that the mints should be used by the Government for the coinage of rupees if required by the public for the exchange of gold. The gold value of the rupee was to be fixed at 1s 4d because this was the average of the silver content of the rupee at the time. The scheme of closing the mint was based on the quantity theory of money. The exchange value of the rupee was then taking a downward course and the exchange value could not be raised unless the supply of rupees was restricted. The closure of the mint was, therefore, the best remedy because it took away the privilege of the private persons to increase the supply of rupees by converting the bullion in their possession into coins.

### **The Effect of the Closure of the Mint**

After the closing of the mint, the exchange value of the rupee came to have little or no reference to the value of the silver contained therein. The face value of the rupee became higher than the bullion value because of the restriction placed on the coinage of rupee. The Government came to have a supreme control over currency affairs. Again although the Government authorised the mints as well as the treasuries to accept gold at the rate of 1s. 4d. gold has not been made legal tender thereby. The silver rupee which was reduced

to the position of a token continued as legal tender to an unlimited extent

### Effect of the Closing of Mints on Exchange

The policy of 1893 did not yield the results that had been hoped for. The exchange value of the rupee began to fall below 1s 4d and by 1896 it touched 13s 6d. There were several reasons which accounted for this continuous fall. The apprehension caused in the minds of people brought out the hoarded silver into circulation. Rupees from outside British India also sought the Indian market. These difficulties were intensified until about 1896. The situation became so embarrassing that the question of Indian Currency was referred to another committee known as the Fowler Committee.

*Question 4* —How has the export of gold in recent years helped in the management of our currency system ?

*Answer* —It has been urged on the side of the Government that the export of Gold has had a favourable effect on the balance of trade and has converted inert metal into live currency. Due to the acute depression which has kept the whole world in its grips (India being no exception) the fall in the exports from our country would have an adverse effect upon the rate of exchange, had there been no exports of gold to pay for imports of India which were in excess of exports during recent years. It has thus served to keep the rupee sterling exchange stable at 1s 6d and greatly improved the credit of India in London and the world. The export of gold has also produced a welcome effect on the Government's financial position so far as the sterling remittances to the Secretary of State and the strengthening of the sterling reserves are concerned. Exports of commodities having fallen down the Government would have been faced with a serious problem in the absence of export bills to provide sterling funds to the Secretary of State for India for meeting home charges and other expenditure on account of India. The export of gold took the place of the export of the commodities and the supply of sterling created against the gold exports was utilised by the Government for remittance purposes. Further the Gold export has brought about an increase in the note circulation, holdings of postal cash certificates, postal savings deposit and bank deposits and have generally created cheap money conditions in the money market.

**Question 5.**—Compare the organisation of Central Banking in England and the U. S. A.

**Answer** —The Central Banking in England is based on "Single Reserve System". The Bank of England is the Central Banking Institution. It is a shareholder's bank and enjoys certain privileges. It is the only Bank of Issue and acts as bankers to the Government. Since all other banks throughout Great Britain keep an account with the Bank of England either directly or indirectly, the Bank of England occupies the unique position of the holder of the ultimate banking reserve. The Bank of England is the support of the whole banking system of England. Its importance lies not in the volume of its business which is usually smaller than that of the major commercial banks but in its currency functions which enable it to regulate the whole money market. The Bank is a shareholders' bank but its work is national rather than more concern of profit making for the shareholders. The Bank is not allowed to do certain kinds of business which clash with its Central Banking functions.

The other Banks, commercial, industrial, co-operative etc., are independent of each other and of the Central Bank. There is no official connection between the various parts of the banking system but all the same there exists a cohesion, a sort of unrecognised but nonetheless strong connection. All the important banks keep their surplus funds and accounts with the Bank of England, conduct clearing business at its offices, make large mutual transfers through it, make provisions for emergency requirements and so on.

#### **American System (U. S. A.)**

The Federal Reserve System of America is entirely different from the Single Reserve System of England. The Federal Reserve System is based on the principle of federation which implies a union of two or more components under a Central body for certain permanent common objects. The Central banking functions are carried on not by a single bank called the central bank but through district reserve banks under the general directions of a board vested with the central banking functions. The vast area of the United States has been divided into twelve districts and in forming these districts the state boundaries have been disregarded. In each of these twelve districts a central bank has been established and these are federated in the Federal Reserve Board. These central banks are banker's banks and each is the pro-

perty of the banks within the area of the central bank. The capital has been compulsorily contributed by the national banks in the proportion of 6 per cent of their capital and surplus. The state banks and Trust Companies are permitted to be members on the same terms as the national Banks. An essential requirement of the Act is the compulsory keeping of certain percentages of cash reserves of the members banks with their respective Federal Reserve Bank.

The management of each Federal Reserve Bank is in the hands of a board of directors and the Federal Reserve Board has one-third of the representation on the directorate of each central banks. The Federal Reserve Board is a co-ordinating and controlling authority of the twelve central banks. It is practically the ultimate banking authority in the U.S.A. The United States treasury exercises considerable influence on this board. The Secretary of the Treasury is chairman and the controller of the currency is also a member of the Board. The other members are appointed by the president of the U.S.A. The Federal Reserve Board is assisted by a body known as the Federal Advisory Committee of 12 members, each Federal Reserve Bank nominating one member.

The functions of the Federal Reserve Board are mainly to approve the discount rates fixed by the Federal Reserve Banks, to control the clearing machinery of these banks and to regulate re-discounts. In short it carries on those functions which central banks perform in the regulation of money market and in the co-ordination of financial activities.

The Federal Reserve Banks are independent of each other. They keep accounts of member banks and of the Government. They are also authorised to issue currency notes but do not enjoy complete monopoly in this respect as the bank of England does. They can extend rediscounting facilities to the member banks and do open market business.

It is thus apparent that the Federal Reserve Banks are similar to the English Central Bank and discharge more or less similar functions for their respective territories. In some ways they are more powerful both as a check and unifying influence. The whole system of banking in the U.S.A. aims at decentralising central banking and thus avoids concentration of credit in a single body, as in England, but with sufficient machinery to mobilise their aggregate resources whenever emergencies may arise. They, however, differ from

the other central Banks, say of Europe, in this respect that the former are not open to public business as a rule. One more point to note is that the European Central Banks have generally first come into existence and then helped the formation and development of general banking but the United States provides an instance of the establishment of Reserve Banks after the general banking had been sufficiently developed and so to say *super imposed* upon the pre-existing system with a view to consolidate, control and strengthen it.

**Question 6.**—How would you link the indigenous banker with the Reserve Bank of India?

**Answer**—Indigenous banker consist of local money-lenders comprising Mooltani and Marwari shroffs and Hindu and Mohammadan Sowkars who form, so to say, the life and soul of petty traders in towns i.e., agriculturists in villages. The important part which the indigenous banking institutions are playing in the internal credit machinery of India need not be elaborated here since it has been recognised by two such important bodies as the Reserve Bank and the Central Banking Enquiry Committee. They finance internal trade and the movement of crops to a considerable extent. They are in fact the only kind of banking institutions available in many parts of the country. They play a prominent part in the remittance of funds from place to place by means of hoondies. It goes without saying, therefore, that they should be effectively linked with the Reserve Bank System if the credit mechanism of the country is to be properly regulated and controlled.

But how such a fusion is to be brought about is the difficult problem. It is not possible for the Reserve Bank under the existing conditions to deal with the indigenous private bankers direct. The number of indigenous banks alone would make any such direct linking impossible. Also the business of these banks is generally of a highly personal and fluid character, so that any real attempt to gauge the amount of credit which could usefully be accorded to them would require personal contact which would necessitate the creation of an impossibly large and costly organisation. The Reserve Bank, therefore, suggests that the best method by which indigenous bankers, under existing conditions and circumstances, can be brought within its scope is by indirect linking. Such indirect linking, the Reserve Bank thinks is a positive and practicable proposal which will ultimately lead

to direct linking when the time is ripe for such a development.

For direct linking the Reserve Bank postulates certain conditions which must be complied by the indigenous bankers before direct linking can take place. The essential conditions are embodied in a tentative scheme which the Reserve Bank formulated in August 1937 for direct linking of private bankers based on the recommendation of the Central Banking Enquiry Committee and regulations relating to banking companies incorporated in the Indian Companies Act. These conditions are —

1 They must confine their business to banking proper as defined by the Indian Companies Act. Any other business that they might be conducting should be wound up within a reasonable time.

2. They must maintain proper books of account, and have them audited by registered accountants, the Reserve Bank will have the right to inspect the accounts and call for any information necessary to determine the financial status of the banker.

3 They must file with the Reserve Bank the periodical statements prescribed for scheduled banks. They must also, in the interests of their depositors, publish the returns prescribed for banking companies by the Companies Act and be liable to the same penalties for non-compliance.

4 The Reserve Bank will have the right of regulating the business of the bankers on banking lines, when necessary.

5 During a period of five years from the date of their registration as private bankers in the books of the Reserve Bank, they will be entitled to open an account at any of the offices of the Reserve Bank and be otherwise subject to the same conditions as the scheduled banks except that during such period they will not be required to furnish the compulsory deposits set out in Section 42 of the Reserve Bank Act, unless any of their weekly statements discloses that their time and demand liabilities are five times or more in excess of their capital in the business.

6 If an indigenous banker does not incorporate himself under the Companies Act, his liabilities in respect of his banking commitments will be unlimited. He should, therefore, state the amount of capital he has available for banking



business. (Bankers with a capital of less than two lakhs need not apply).

7. When required they will have to indicate

- (a) the names and the extent of interest of their business partners if any, and
- (b) if any of the bankers is a member of a Hindu joint family, the names and interests of the co-sharers. In both the cases statements will be required from the co-sharers that they are prepared to take their full share in the business and its liabilities.

8 This Scheme will be a tentative one for a term of five years, but before the end of this period the Reserve Bank will frame proposals for legislation, if it thinks fit further to co-ordinate or regulate the position of the private banker. It is likely that such legislation would take the form of a separate Bank Act as suggested by the Banking Enquiry Committee or otherwise to standardise and co-ordinate the status of these registered private bankers on lines in consonance with the scheduled banks.

If the indigenous bankers satisfy the above conditions they will have the privilege of rediscount with the Reserve Bank against eligible paper, the right to secure advances against Government paper and remittance facilities similar to those of the scheduled Banks.

The Shroff Association is not in favour of indirect linking and desires that direct linking be inaugurated immediately. The indigenous bankers, however, are not agreeable to observe some of the conditions. They disagree with the suggestions regarding the taking of deposits and giving wide publicity to their accounts. They are also not prepared to confine themselves to banking business. Thus a deadlock exist between the Shroffs and the Reserve Bank. The Reserve Bank is, therefore, not prepared to make any recommendation to the Government for the amendment of the Reserve Bank Act.

It is a matter of regret that the question of establishing the much desired direct link has been indefinitely postponed. This problem is one of proper reapproachment. So long as the indigenous bankers remain outside the orbit of the Reserve Bank the latter can neither effectively control the credit requirements of the country nor unify the Indian money market. The Reserve Bank should relax some of the conditions prescribed for direct linking, for instance, the condition

of taking deposits as the principal business of the Shroff may be waived for a few years to begin with. The Indigenous banker must also be prepared in the interest of his customers as well as in order to bring himself within the banking framework of the country, to organise his business on recognised banking principles and practises. Direct linking can be possible if the private bankers confined their activities to banking proper and adopted modern banking methods.

*Question 7* — Explain the nature of forward transactions in a Stock Exchange. Give illustrations.

*Answer* — There are several ways of dealing on the stock exchange. The ordinary methods are either "for Money" or "for the Account". "Dealing for Money" means that the transactions are actually paid for at the time they are made i.e., the purchase is for ready money, consequently such bargains are usually cheaper in price than those made "for the account".

Dealing for the Account means that the transaction will be taken and paid for, or "differences" on the next half monthly settling day following the date of purchase. Such transactions are frequently called "Time Bargains" from the fact that a longer or shorter time must elapse from the time they are made to the day they are closed and in this intervening time the price of the security operated in may materially alter either against the speculator or in his favour. An operation for the Account has the option to close his bargain at any time before the settlement day and can take advantage of any slightest variation in the price in his favour. Owing to sudden and violent fluctuations caused by some monetary influence upon the price it is possible to close a transaction at a profit a few minutes after the bargain has been completed. The price of securities bought for the Account is usually higher than that paid "for Money" and when this is the case there is said to be a *contango* in the forward price, for instance, if  $3\frac{1}{4}$  per cents were quoted "Money 98" and "Account  $98\frac{1}{8}$ " there should be a *contango* of  $\frac{1}{8}$ th in the Account price.

By far the greater part of the dealing in the Stock Exchange are of a purely speculative nature, made by persons who are unable, or unwilling to pay for the securities they purchase for or who do not possess the stocks they agree to sell. Such dealers anticipate that they will be able

to buy or sell again at a profit before the settlement arrives. Speculators of this type are called "Bull" and "Bears"

A "Bull" is a speculator who buys "on account" for the rise; he buys in the hope of selling to another person before the settlement day. He never intends to take up and pay for his stock but he contracts to buy it in the hope that he will be able to sell at a higher price to another person before the settlement and thus make a profit on the transaction. If a profit is made he merely claims the difference between his buying and selling price, never handling the securities at all. Should, however, the price go down by "Contango Day" such speculators either have to sell their bargains at market price and pay the difference necessary to balance the account, or, if they do not wish to actually close up and abandon their holding, they may, by the arrangement "carry over" to the next account still hoping that the transaction will turn out to be profitable.

A "Bear" is just the reverse of a "Bull". he sells for a fall in price. To illustrate a "Bear" transaction let us suppose that a speculator has reason to believe that  $3\frac{1}{2}$  per cent will fall in price before the next settlement and that, acting in the belief he sells "for the Account", say Rs. 10,000  $3\frac{1}{2}$  per cent at 99, or for Rs. 9,900. He does not possess the stock but if the price by "Contango Day" falls to, say Rs. 98 he could purchase Rs. 10,000 for Rs. 9,800, thus fulfilling his contract and gaining Rs 100 on the bargain, less expenses, viz., brokerage, commission etc., neither delivering the stock nor receiving it but simply claiming the difference between the buying and selling prices. On the other hand, if the price rose to Rs. 99-8-0 there would result to him a loss of Rs. 50 which he must pay. Or he might elect to "carry over" his bargain till the next settlement still hoping that the price would fall sufficiently to enable him to close the transaction at a profit.

Besides the ordinary modes of dealing, as described above extensive transaction are now carried on by means of "options". This is a favourite way of operating by persons who wish to limit their liability when speculating for a rise or fall in price. "Options" are also extensively used by speculators to protect their "bulls" and "bears".

An option is a mode of speculating by which a person pays down so much per cent (or so much per share) for the option to buy or sell a named quantity of stock (or so many shares) at a fixed price on a certain day. The option to buy is termed a 'call', the option to sell, a 'put', and the double option to buy or sell a "put and call". The advantage offered by this system is that the profit may be unlimited while the possible loss is fixed at the amount paid for the option. The option money is not returnable in any case whether the transaction ends profitably or not as it is really a premium paid to the dealer for taking the risk of the market going against him. All options carry with them the privilege of being able to close at any moment before the contract time expires, and they may be made from day to day, for one, two, three or more accounts, or for a certain specified date, the option price varying according to the securities dealt with and the length of the time for which the option is to run.

*Question- 8* —Discuss the effects of the First Great War on Indian Trade.

*Answer* —The following tables bring out the effects of the War on India's trade.

TABLE I

Value (in millions of pounds) of the overseas trade in total merchandise).

	1913-14	1914-15	1915-16	1916-17	1917-18	1918-19
Imports	127.5	96.5	92.1	106.8	109.6	125.7
Exports	166.0	121.4	133.0	167.9	163.3	170.2

TABLE II

Value (in millions of pounds) of the overseas trade (total merchandise calculated at the price current in 1913-14).

	1913-14	1914-15	1915-16	1916-17	1917-18	1918-19
Imports	127.5	96.6	73.1	62.8	51.9	46.9
Exports	106.0	119.0	129.1	140.9	130.6	133.5

In order to understand clearly the effects of the war on the volume of trade it is necessary to take into account the rise in price which took place during the war years. This particularly applies to the imports which rose in value more than the exports. Taking 100 as the Index figure of prices of export and imports in 1913-14, while the prices of exports rose to 150 those of the imports jumped to 268. Even when an account only of the recorded values of exports and imports is taken, Table I indicates that both branches of the foreign trade received a severe set-back on the outbreak of the war and that while the value of the exports recovered from 1916-17 onwards, that of exports remained behind the pre-war level even so late as in 1918-19. Table II, however, shows that there was a far more serious reduction in the volume of trade, especially of the import trade, which declined continuously throughout the war years. The reasons which contributed to bring out this state of affairs may be summed up as below —

1. The export had increased far more rapidly than imports on account of the urgent demand for India's products by the belligerents. Large quantities of sand bags for trench warfare and hides for the manufactures of boots for soldiers were required and this greatly stimulated the export in later years.

2. The imports, on the other hand, had decreased on account of the check on the exporting capacity of the belligerents. Trade with the allied countries like Great Britain, France and Belgium could not be maintained on the same level owing to their preoccupation with war.

3. Imports from enemy countries ceased altogether. The discontinuance of trade with Germany was particularly serious.

4. Trade with neutral countries was restricted in order to make Indian supplies available solely for the Allies.

5. World's exchanges became disorganised. The export trade of India would have shown an even larger increase in later years of the war had it not been for the difficulties regarding export finance arising from the curtailment of the sale of council bills and from Government control.

6. Throughout the war less ships were available and so the freight charges rose very high. The tonnage difficulty particularly affected India on account of her greater distance

from western Europe than other suppliers of raw materials to Europe like the Argentine, Brazil, Canada, and the United States of America.

One wholesome feature of India's War-time foreign trade was the increase in the exports of manufactures whose percentage to the total exports trade rose from 22.4 per cent in 1913-14 to 36.6 per cent, in 1918-19. The War gave an artificial stimulus to Indian industries like Cotton, Jute, Leather, Steel and Iron and this accounts for the increase in the exports of manufactures.

The war brought about an important change in the direction of India's foreign trade. The share of the United Kingdom fell during the war period from 64.1 per cent in 1913-14 to 45.5 per cent in 1918-19, while that of Japan and U. S. A. increased considerably. Iron and steel and hardware previously supplied by the United Kingdom had now to be imported from these countries while glassware, cotton piece-goods, papers, etc., had to be imported from Japan and Dye-stuffs from the United States.

On the export side, there appeared a tendency for the temporary reversion of the trade to the United Kingdom and the British Empire as a result of the War-time purchases and special measures taken to restrict Indian Trade with neutral Countries. The result was that the share of the United Kingdom in the Indian exports improved from 23.4 per cent in 1913-14 to 29.2 per cent in 1918-19, while the share of British Empire as a whole increased from the pre-war average of 41.1 per cent to 51.7 per cent. Germany disappeared altogether as a buyer from the Indian market. The shares of France and Belgium were also reduced but Japan and the United States increased their shares appreciably.

**Question 9** — What determines the gain from international trade?

**Answer** — The principle of comparative costs lies at the bases of the foreign trade and determines the gain which countries may derive from it. Nations engage their capital and labour in those industries with regard to which they have the highest relative advantage over other nations. Two countries A and B can both make boots, but A can produce both coats and boots more cheaply than B. This results in A less labour in each. It is hardly that B is better to the same extent in both coats and boots; if B is not there would be gain for both by A's concentrating upon the job in

which he has the greatest start and by B's concentrating the job in which he is least handicapped. Let us examine the matter as a little problem in arithmetic.

Assume that there are only two countries in the "A" and "B" and that each produces only the two commodities, coats and boots, both of which are capable of being exported. Further assume that cost of transport may be ignored. The units of productive power are to be taken in terms of labour. Imagine the case when country A has an absolute advantage over country B in the production of commodities.

Country A 100 men employed on coats can produce 100 units, 100 men employed on boots can produce 150 units in the same time.

Country B 100 men employed on coats can produce 50 units, 100 men employed on boots can produce 100 units.

In such circumstances there can be no trade between the two countries since the ratio of "A's" productivity to "B's" is the same in each case  $2:1$ .

If, however, we substitute the following —

Country A 100 men employed on coats can produce 100 units, 100 men employed on boots can produce 150 units in the same time.

Country B 100 men employed on coats can produce 50 units, 100 men employed on boots can produce 100 units.

Now in country A 1 unit of coat is equal to  $1\frac{1}{2}$  units of boots. In country B 1 unit of coat is equal in cost to 2 units of boots.

Evidently instead of producing coats itself B will be willing to take in exchange from A 1 unit of coat for anything less than 2 units of boots and A will be right glad if instead of producing boots it can get anything more than  $1\frac{1}{2}$  units of boots for 1 unit of coats. Thus it can get from B A will produce only coats and B only boots. Trade, therefore, arises between A and B not because A can produce coats at less real cost than country B but because there are differences between the relative costs at which the two countries can produce. This is the law of comparative costs and which has been succinctly stated by Cairnes in the following terms "The one condition essential to and also sufficient for, the existence

of international trade is a difference in the comparative as contra-distinguished from the absolute cost of producing the commodities exchanged". When country A specialises, as she certainly will, in coats, leaving country B to specialise in boots, the following will be the result:—

Country A will have 200 men engaged in producing 200 units of coats.

Country B will have 200 men engaged in producing 200 units of boots.

A total production of 200 units of coats and 200 units of boots.

There is thus a gain of 50 units of coats less 50 units of boots. This is a net gain which shall be shared between A and B. How this net gain will be divided? The answer to this question is that the division will be in proportion to the intensity of reciprocal demand. The advantage of foreign trade is that more wealth is produced and becomes available to the countries dealing with one another in the course of international commerce. However, although, all derive a benefit, the benefit is not uniform. The proportion in which the benefit of international trade is distributed among the countries depends on their relative intensity of demand for each other's goods.

*Question 10* —Discuss the organisation and problems of one of the following industries in India —

(a) Cotton Industry.

(b) Sugar Industry

*Answer.*—When the Cotton Mill Industry was started on a large scale in India at the end of the last and at the beginning of the present century, it was concentrated in two centres of Bombay Presidency, viz., Ahmedabad and Bombay City and Island. The early concentration of the Industry in the Bombay Island has been governed by such factors as abundant supply of capital and credit facilities, the presence of cheap and speedy means of transport and the temporary growth of the demand for yarn from China which Bombay was in an exceptionally favourable situation to meet. Bombay was also initially favoured with an adequate supply of good cotton near at hand. The favourable situation of the city was also a considerable advantage from the point of view of importation of machinery, mills



store and coal. Lastly, the urge for industrialisation was great in Bombay than elsewhere on account of the agricultural backwardness of the Province. But feature of post-war development and particularly during the last decades in the textile industry has been the tendency to spread throughout the country rather than to concentrate in the Bombay Presidency. This feature has been in evidence particularly in Madras and Bengal. The reasons for such a tendency are not far to seek. Climate is now not more important a factor as it once was since it can be regulated in factories as desired by artificial methods. Cotton is at present grown extensively in several provinces. Capital is no longer shy in India and is forthcoming without much difficulty for the financing of undertakings having reasonable prospects of success. Again, as India is a country of long distances, freight charges have become an important factor in shaping the lines of industrial development, consequently, decentralisation rather than concentration is the present-day tendency in regard to the Cotton Mill Industry. Finally, labour, skilled and unskilled is available comparatively cheaper in other centres than in Bombay and Ahmedabad. For these reasons up country centres like Sholapur, Nagpur, Cawnpore, Delhi have rapidly developed the cotton mills.

Until the beginning of the present century, the principal products of the mill was yarn meant for the consumption of the Indian Handloom Industry and for export to China but the Chinese market was soon lost and the Indian Mills began to concentrate their energies on the production of yarn and cloth for home consumption. Consequently, there has been a great advancement in the weaving branch of the industry and at present there is in evidence a tendency to increase the manufacture of finer counts, a certain amount of long staple cotton being imported from U S A. and elsewhere for this purpose. The industry progressed rapidly from the eighteen-eighties onwards in spite of the temporary setbacks due to plague and draught, the rise of Japanese competition in India's foreign markets, exchange difficulty and high prices of cotton. During the war, the industry experienced unparalleled prosperity on account of the impossibility of obtaining imports from Lancashire and due to the Government patronage in respect of military requirements for cotton goods. Due, however, to the difficulty of obtaining machinery and plant few new mills were constructed, the existing mills, on the other hand, worked at top speed and obtained high profits. The Swadeshi Movement led by Mahatma Gandhi gave a further stimulus to the industry. Much improvement

has been made in the matter of spinning yarn of higher counts. The cloth produced in some cases is very superior and of much finer counts. The area of competition with imported yarn and cloth has now been extended. Three post-war years were years of boom for the Cotton Industry when huge profits were earned. In subsequent years, the industry, however, suffered from trade depression and excessive competition from Japan, in Indian markets. Not only Japan snatched away from India the Chinese market for Indian exports but she also invaded the Indian market itself with cheap yarn and piece-goods. The Indian Industry, however, was able to largely overcome this difficulty with the help of the protection it enjoyed since 1927. The Japanese competition also came to be regulated by the Indo-Japanese Trade Agreement which restricted the maximum quantities of imports of Japanese piece-goods into India on a quota basis, Japan undertaking the import of certain quantity of Indian Cotton against a certain amount of her exports of cotton goods into India.

*The War Years.*—After a continuous period of almost unrelieved gloom extending over a period of nearly two decades, culminating in measures being actively explored with a view to bringing about an organised curtailment of production throughout the country, the war in Europe which commenced in September 1939 opened up the prospect of a spell of prosperity for the industry. Following the cessation of trade with Japan, which happened to be the leading supplier of cotton textile to the East in December, 1941, the Indian cotton textile industry enjoyed a completely monopolistic position. It was faced with a steadily expanding demand from overseas, an increasing volume of war orders and growing domestic requirements for civil purposes stepped up by inflationary forces. The cloth production was stepped up from 4,012.4 million yards in 1939-40 to the record level of 4,870.6 million yards in 1943-44. Yet the industry was unable to meet the growing demand and the prices were pushed up to four times the pre-war levels.

In May, 1943, the Government of India issued the cotton cloth and yarn (control) order based on an agreement between the Government of India and the representatives of the textile industry. Its objects were to reduce prices and stimulate production by controlling the cost and supply of mill stores and by regulating the price of raw cotton and by superintending the distribution of cloth from the mills to the retailers. The control authorities were, however, faced

with a formidable task created by reduction in output due to coal shortage and *hartals* on the one hand and growing demand on the other. Consequently, though in the following two years, the prices stamped on the cloth were brought down by about 60% the full benefit was not passed to the consumer owing to widespread black market activity, mainly encouraged by illicit exports due to trade regulations and large scale hoarding as inflation hedge.

The latest supply position was reviewed by the Chairman of the Textile Control Board recently when he said: "In the calendar year 145 Indian cotton mills produced 4,687 million yards of cloth and 1,625 million lbs. of yarn in 1944 and 4,715 million yards of cloth and 1,620 million lbs of yarn in 1943. The loss in production in 1944 is primarily due to stoppages of mills for lack of coal or inferior coal. In 1945 a higher production might have been attained had it not been for a large number of spindles and loom hours lost through *hartals*, shortage of labour, shortage of raw materials, etc. It is estimated that the total quantity of cloth and yarn exported in 1945 would be approximately 387 million yards of cloth and 13 million lbs of yarn as compared with 434 million yards of cloth and 18 million lbs of yarn in 1944. Supplies of cloth and yarn for defence services in 1945 have amounted to 417 million yards of cloth and 25 million lbs of yarn as compared with 583 million yards of cloth and 28 million lbs of yarn in 1944. The net available supplies of mill made cloth for civilian consumption in 1945 amount, therefore, to 3,883 million yards as compared with 3,794 million yards in 1944. Including handloom, it is estimated that the cloth available for the civilian population of the sub-continent in 1945 is approximately 14 yards per head per annum for a population of 400 million."

*Exports.*—The table below sets out the exports of cotton twist and yarn from the sub-continent to its chief export markets —

	1941-42	1943-44	1944-45	1945-46
	lbs	lbs.	lbs.	lbs
United Kingdom	3651838			
Burma	29165816			
Straits Settlement	2506320			
Hongkong	3881286			
Syria	1547100	14000	841360	482900
Others	49776205	18922952	16077053	14014041
Grand Total	90528503	18936952	16018413	14496941

The table below sets out the "exports of cotton" piece-goods to foreign countries

(In Thousands of yards)						
1940-41						
Burma	117706	61827				
Iran	36	7784	39658	8900	11565	5367
Iraq	5710	19608	77773	12750	25172	34063
Straits Settlements	24719	35133	...	...	...	...
Aden etc	552	23108	41715	34460	52769	37089
Kenya ,,	45587	69337	42930	40589	28615	37833
Ceylon	27001	26273	45419	37646	33800	27585
Portuguese East Africa	5093	2301	2094	204	285	818
Others	109477	400584	439149	326788	260816	297755
Grand Total	335881	645855	688738	461337	423021	440510

In relation to the world cotton textile industry, the Indian industry ranks second from the point of view of spindles and looms installed. The position of the mill industry in the economy of the sub-continent will be evident from the fact that, at the present time, it consumes more than 70% of the total cotton crops directly gives employment to over 500,000 workers, and affords subsidiary employment to large numbers of persons who are engaged in various trades which directly depend for their existence upon the cotton mills industry.

India is the birth place of the Cotton Industry [and the place of the Cotton Textile Industry in the national economy of India is second only to that of agriculture. Alike in capital sunk in the industry and the volume of employment which it creates and the net addition to the total wealth and income of the country, it has no rival among our industries. India is rich in her cotton resources, she has the requisite labour to supply for the Cotton Textile Industry there is no dearth of industrial capital, and captains of industry who are prepared to shoulder the risks of the venture are forthcoming. India with its vast population affords a great market for the

home products. The prospects of the industry are not dark but, of course, the industry requires to be organised on sound lines and competition with older and strong foreign countries is kept at arm's length by protected duties of such like measures. There are also certain other matters which deserve the close attention of the mill-owners, if they desire to consolidate their positions for future emergencies. Firstly, the benefits of the present revival should be utilised in the set purpose of stabilising the industry on a finer basis. Frittering away higher earnings on bumper dividends and bonus without giving any thought to the uncertainties of the future will have to be avoided. The lessons of the past are too poignant to be retold. Secondly, there is the question of the exploration of the possibility of corporate advertising to 'boost' Indian Mill Cloth. The creation of a central publicity organisation financed by leading Mill-owner's Organisation mainly for press advertisements and propaganda purposes should be one of the first efforts for the drive towards prosperity.

The industry suffers from a basic weakness. As in 1919 so in 1948 it depends on foreign countries for supply of textile machinery, spare parts and oils, chemicals and even long stapled cotton.

The industry needs rationalisation in many respects in the use of improved machinery improved labour efficiency, better purchases of raw materials, in the standardisation of products and in the marketing, management and finance of the industry.

There has been regional specialisation in the cotton industry. Bombay produce cloth mainly of light texture from medium and higher count yarn. Ahmedabad has specialised in Dhotis and Saris. Madras produces high class cotton coatings, and bleached shirting, and drills. Southern India has developed a large spinning industry. Mills in northern India produce mostly coarser cloth.

The last war has no doubt disturbed this specialisation. It is suggested that mill products should be standardised and certain mills should be asked to produce certain quantities. Efforts should be made at simplification, specialisation and standardisation of products. Duplication of work should be avoided and uneconomic machinery eliminated.

Bombay had the initial concentration of the industry although in this century the textile industry has spread to the interior. A time has come when the industry should be further decentralised if it is to be put on a healthy basis. Now that hydro-electric schemes are being developed all over the country and cotton is grown practically everywhere the industry can develop in areas with large and prosperous population.

Labour problem is the most difficult to tackle. Labour has grown more conscious, economically and politically during the war years. The worker is not satisfied with a living wage. He wants a share in the management and ownership of the concern in which he works. No doubt labour was exploited in the past by the industrialists and their own personal benefits. Steps should be taken to ensure that labour is treated fairly well. But labour should also be in a reasonable frame of mind. They should "work more and get more" and should not "go slow and expect more". They should realise that rights and liabilities should go together.

Lastly, the industry should devote attention to the development of technical education and education in the art of mill management. So far finance without the accompaniment of technical education has dominated the industry. This gap must be bridged over as early as possible.

Planning should be on all-India basis and the distribution of new plants and extensions of the existing plants should follow territorial divisions of India.

(2) Sheltered behind an adequate tariff wall, the Indian sugar industry has made phenomenal progress in spite of the economic depression. The main difficulty in the way of establishing new large factory industries during recent years of depression has been that finding a party or company able or willing to face financial risks involved. In the case of sugar industry, the risk was removed by tariff legislation. Besides the duty, various other special advantages—consequent upon the depression—have helped the rapid growth of the industry. Low price of land and materials as also of machinery—all these factors have contributed to the remarkable development of the industry. The year 1930-31 is

a landmark in the history of sugar industry. It was in this year, that the question of protection of the Sugar industry was referred to the Tariff Board by the Government. From 13th September 1931 an import duty of Rs 9-11-0 per cwt. was imposed on all imports of sugar—a protective duty of almost 200% on the price at which sugar was then being imported from Java.

The progress of the industry after the grant of protection has been phenomenal, as can be seen from the fact that while in 1932-33, the number of sugar mills was only 57 it increased to over 137 in 1935-36 and to 151 in 1943-44 but came down to 140 in the following years.

The following table shows the number of cane factories working in India, including States, and production of sugar from cane factories, gur refineries, khandasari, net import of sugar in British India and import in Kathiawar ports during the last 15 years.

Year (Nov Oct)	No. of cane Factories working in India.	Cane factories Production (Nov.-Oct.)	Sugar refined from Gur. (Jan-Dec)	Khandasari Conjectural estimates (Nov.-Oct.)	Total Pro- duction of Sugar in India (Nov- Oct.)	Net Imports		Imports of sugar in Kathiawar Ports (Nov.- Oct.)
						(Excluding Re-exports) of sugar in British India (Nov.-Oct)	Tons	
		Tons	Tons	Tons	Tons	Tons	Tons	
1932-33	57	290,177	80,106	275,000	645,383	321,081	68,649	
1933-34	112	454,000	64,900	200,000	718,900	233,366	87,094	
1934-35	130	578,100	43,500	150,000	771,600	197,775	113,364	
1935-36	137	932,100	47,900	125,000	1,105,000	86,962	45,218	
1936-37	137	1,111,400	25,600	100,000	1,237,000	11,160	12,870	
1937-38	136	930,700	17,200	125,000	1,072,900	9,410	12,238	
1938-39	139	650,800	14,700	100,000	762,500	254,400	77,000	
1939-40	145	1,241,700	26,500	125,000	1,393,200	34,093	32,743	
1940-41	149	1,095,400	44,700	2,000,000	1,340,100	27,934	15,283	
1941-42	150	778,100	20,400	100,000	898,500	23,843	6,608	
1942-43	150	1,070,700	7,800	214,000	1,292,502	8	..	
1943-44	151	1,216,400	7,700	150,000	1,374,000	14	...	
1944-45	140	953,500	6,400	125,000	1,084,900	30	...	
1945-46	145	944,800	4,000	117,000	1,065,800	...	...	
1946-47	141	928,200	4,000	110,000	1,142,200	...	...	



The sugar industry was controlled since 1942 by the Government of India, and this control was maintained all throughout the period of the war and upto 10th December, 1947, when control over sugar was lifted. Along with sugar, production of gur was also controlled. While the control succeeded to a certain extent in achieving its object, namely, check over indiscriminate rise in prices, it failed to increase production of sugar, although it was the avowed object of the Government to increase production. With the decontrol of sugar and the fixation of higher prices of sugar by the Government of India, with effect from the 1947-48 crushing season, in order to enable them to enhance the minimum price of the raw materials, namely, sugarcane, from Re 1/4/- per maund to Rs 2/- per maund in the U P. and Bihar, principal sugar-producing provinces of the country, it is hoped that larger quantities of sugarcane will be available to sugar mills for crushing, and that consequently production of sugar will increase in order to meet the requirements of sugar in the country which have been steadily going up since the last few years.

*Capital Outlay.*—The capital invested at the present time in the sugar industry is roughly of the order of 35 crores of rupees. The Sugar Panel estimated that the total cost of machinery required for (a) fuller exploitation of the existing capacity of the sugar factories, (b) enhancement of the capacity of the existing small plants, and (c) construction of 20 new factories of 1,000 tons of cane per day crushing capacity, would be about 11-12 crores of rupees. If to this we add the cost of establishment 25 new factories decided by the Government of India while reviewing the recommendations of the Sugar Panel in 1947, the total cost would be about 22 crores of rupees for the machinery.

A large bulk of the existing sugar machinery had been imported from various countries, e.g., U K., Germany, Czechoslovakia, France, etc. but it is impossible that in the years to come certain units of the sugar machinery can be fabricated in India, and if the new plants are fabricated in India, it would be of great help to the engineering industry of the country as well.

*Import Possibilities*—Although production of sugar in India at the present time is slightly less than its estimated consumption, it is not likely that there will be any large-sized import of sugar from foreign countries, firstly, because production of sugar in the world is at present smaller than the

of taking deposits as the principal business of the Shroff may be waived for a few years to begin with. The Indigenous banker must also be prepared in the interest of his customers as well as in order to bring himself within the banking framework of the country, to organise his business on recognised banking principles and practises. Direct linking can be possible if the private bankers confined their activities to banking proper and adopted modern banking methods.

*Question 7* — Explain the nature of forward transactions in a Stock Exchange. Give illustrations.

*Answer* — There are several ways of dealing on the stock exchange. The ordinary methods are either "for Money" or "for the Account". "Dealing for Money" means that the transactions are actually paid for at the time they are made, i.e., the purchase is for ready money, consequently such bargains are usually cheaper in price than those made "for the account."

Dealing for the Account means that the transaction will be taken and paid for, or "differences" on the next half monthly settling day following the date of purchase. Such transactions are frequently called "Time Bargains" from the fact that a longer or shorter time must elapse from the time they are made to the day they are closed and in this intervening time the price of the security operated in may materially alter either against the speculator or in his favour. An operation for the Account has the option to close his bargain at any time before the settlement day and can take advantage of any slightest variation in the price in his favour. Owing to sudden and violent fluctuations caused by some monetary influence upon the price it is possible to close a transaction at a profit a few minutes after the bargain has been completed. The price of securities bought for the Account is usually higher than that paid "for Money" and when this is the case there is said to be a contango in the forward price, for instance, if  $3\frac{1}{2}$  per cents were quoted "Money 98" and "Account  $98\frac{1}{2}$ " there should be a contango of  $\frac{1}{2}$ th in the Account price.

By far the greater part of the dealing in the Stock Exchange are of a purely speculative nature, made by persons who are unable or unwilling to pay for the securities they purchase for or who do not possess the stocks they agree to sell. Such dealers anticipate that they will be able

to buy or sell again at a profit before the settlement arrives. Speculators of this type are called "Bull" and "Bears".

A "Bull" is a speculator who buys "on account" for the rise; he buys in the hope of selling to another person before the settlement day. He never intends to take up and pay for his stock but he contracts to buy it in the hope that he will be able to sell at a higher price to another person before the settlement and thus make a profit on the transaction. If a profit is made he merely claims the difference between his buying and selling price, never handling the securities at all. Should, however, the price go down by "Contango Day" such speculators either have to sell their bargains at market price and pay the difference necessary to balance the account, or, if they do not wish to actually close up and abandon their holding, they may, by the arrangement "carry over" to the next account still hoping that the transaction will turn out to be profitable.

A "Bear" is just the reverse of a "Bull" he sells for a fall in price. To illustrate a "Bear" transaction let us suppose that a speculator has reason to believe that  $3\frac{1}{2}$  per cent. will fall in price before the next settlement and that acting in the belief he sells "for the Account", say Rs 10,000  $3\frac{1}{2}$  per cent at 99, or for Rs 9,900. He does not possess the stock but if the price by "Contango Day" falls to, say Rs. 98 he could purchase Rs. 10,000 for Rs. 9,800, thus fulfilling his contract and gaining Rs. 100 on the bargain, less expenses, viz., brokerage, commission etc., neither delivering the stock nor receiving it but simply claiming the difference between the buying and selling prices. On the other hand, if the price rose to Rs 99-8-0 there would result to him a loss of Rs. 50 which he must pay. Or he might elect to "carry over" his bargain till the next settlement still hoping that the price would fall sufficiently to enable him to close the transaction at a profit.

Besides the ordinary modes of dealing, as described above extensive transaction are now carried on by means of "options". This is a favourite way of operating by persons who wish to limit their liability when speculating for a rise or fall in price. "Options" are also extensively used by speculators to protect their "bulls" and "bears".

An 'option' is a mode of 'speculating' by which a person pays down so much per cent (or so much per share) for the option to buy or sell a named quantity of stock (or so many shares) at a fixed price on a certain day. The option to buy is termed a 'call', the option to sell, a 'put', and the double option to buy or sell a "put and call". The advantage offered by this system is that the profit may be unlimited while the possible loss is fixed at the amount paid for the option. The option money is not returnable in any case whether the transaction ends profitably or not as it is really a premium paid to the dealer for taking the risk of the market going against him. All options carry with them the privilege of being able to close at any moment before the contract time expires, and they may be made from day to day, for one, two, three or more accounts, or for a certain specified date, the option price varying according to the securities dealt with and the length of the time for which the option is to run.

*Question- 8.*—Discuss the effects of the First Great War on Indian Trade.

*Answer.*—The following tables bring out the effects of the War on India's trade.

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Value (in millions of pounds) of the overseas trade in total merchandise).

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Exports	106.0	119.0	129.1	140.9	130.6	133.5

In order to understand clearly the effects of the war on the volume of trade it is necessary to take into account the rise in price which took place during the war years. This particularly applies to the imports which rose in value more than the exports. Taking 100 as the index figure of prices of export and imports in 1913-14, while the prices of exports rose to 150 those of the imports jumped to 268. Even when an account only of the recorded values of exports and imports is taken, Table I indicates that both branches of the foreign trade received a severe set-back on the outbreak of the war and that while the value of the exports recovered from 1916-17 onwards, that of imports remained behind the pre-war level even so late as in 1918-19. Table II, however, shows that there was a far more serious reduction in the volume of trade, especially of the import trade, which declined continuously throughout the war years. The reasons which contributed to bring out this state of affairs may be summed up as below:—

1. The export had increased far more rapidly than imports on account of the urgent demand for India's products by the belligerents. Large quantities of sand bags for trench warfare and hides for the manufactures of boots for soldiers were required and this greatly stimulated the export in later years.

2. The imports, on the other hand, had decreased on account of the check on the exporting capacity of the belligerents. Trade with the allied countries like Great Britain, France and Belgium could not be maintained on the same level owing to their preoccupation with war.

3. Imports from enemy countries ceased altogether. The discontinuance of trade with Germany was particularly serious.

4. Trade with neutral countries was restricted in order to make Indian supplies available solely for the Allies.

5. World's exchanges became disorganised. The export trade of India would have shown an even larger increase in later years of the war, had it not been for the difficulties regarding export finance arising from the curtailment of the sale of council bills and from Government control.

6. Throughout the war less ships were available and so the freight charges rose very high. The tonnage difficulty particularly affected India on account of her greater distance.

from western Europe than other suppliers of raw materials to Europe like the Argentine, Brazil, Canada, and the United States of America.

One wholesome feature of India's War-time foreign trade was the increase in the exports of manufactures whose percentage to the total exports trade rose from 22.4 per cent in 1913-14 to 36.6 per cent, in 1918-19. The War gave an artificial stimulus to Indian industries like Cotton, Jute, Leather, Steel and Iron and this accounts for the increase in the exports of manufactures.

The war brought about an important change in the direction of India's foreign trade. The share of the United Kingdom fell during the war period from 64.1 per cent in 1913-14 to 45.5 per cent in 1918-19, while that of Japan and U. S. A. increased considerably. Iron and steel and hardware previously supplied by the United Kingdom had now to be imported from these countries while glassware, cotton piece-goods, papers, etc., had to be imported from Japan and Dye-stuffs from the United States.

On the export side, there appeared a tendency for the temporary reversion of the trade to the United Kingdom and the British Empire as a result of the War-time purchases and special measures taken to restrict Indian Trade with neutral Countries. The result was that the share of the United Kingdom in the Indian exports improved from 23.4 per cent. in 1913-14 to 29.2 per cent in 1918-19 while the share of British Empire as a whole increased from the pre-war average of 41.1 per cent to 51.7 per cent. Germany disappeared altogether as a buyer from the Indian market. The shares of France and Belgium were also reduced but Japan and the United States increased their shares appreciably.

**Question 9** — What determines the gain from international trade?

**Answer** — The principle of comparative costs lies at the bases of the foreign trade and determines the gain which countries may derive from it. Nations engage their capital and labour in those industries with regard to which they have the highest relative advantage over other nations. Two countries A and B can both make boots, but A can produce both coats and boots more cheaply than is the same results cost A less labour in each. It is hardly that B is better to the same extent in both coats and boots; if B is not there would he gain for both by A's concentrating upon the job in

which he has the greatest start and by B's concentrating upon the job in which he is least handicapped. Let us examine the matter as a little problem in arithmetic.

Assume that there are only two countries in the world "A" and "B" and that each produces only the two commodities, coats and boots, both of which are capable of being exported. Further assume that cost of transport may be ignored. The units of productive power are to be taken in terms of days of labour. Imagine the case when country A has an absolute advantage over country B in the production of both commodities

Country A 100 men employed on coats can produce 100 units; 100 men employed on boots can produce 150 units in the same time.

Country B: 100 men employed on coats can produce 50 units, 100 men employed on boots can produce 75 units.

In such circumstances there can be no trade between the countries since the ratio of "A's" productivity to "B's" is same in each case i. e. 2 to 1.

If, however, we substitute the following —

Country A 100 men employed on coats can produce 100 units 100 men employed on boots can produce 150 units in the same time.

Country B 100 men employed on coats can produce 50 units 100 men employed on boots can produce 100 units.

Now in cost of productive power 1 unit of coat in A is equal to  $1\frac{1}{2}$  unit of boot in B 1 unit of coat is equal in cost to 2 units of boots.

Evidently instead of producing coats itself B will be willing to take in exchange from A 1 unit of coat for anything less than 2 units of boots and A will be right glad if instead of producing boots it can get anything more than  $1\frac{1}{2}$  units of boots for 1 unit of coats This it can get from B A will produce only coats and B only boots. Trade, therefore, arises between A and B not because A can produce coats at less real cost than country B but because there are differences between the relative costs at which the two countries can produce This is the law of comparative costs and which has been succinctly stated by Cairnes in the following terms "The one condition essential to and also sufficient for, the existence

of international trade is a difference in the comparative as contra-distinguished from the absolute cost of producing the commodities exchanged" When country A specialises, as she certainly will, in coats, leaving country B to specialise in boots, the following will be the result.—

Country A will have 200 men engaged in producing 200 units of coats.

Country B will have 200 men engaged in producing 200 units of boots.

A total production of 200 units of coats and 200 units of boots.

There is thus a gain of 50 units of coats less 50 units of boots. This is a net gain which shall be shared between A and B. How this net gain will be divided? The answer to this question is that the division will be in proportion to the intensity of reciprocal demand. The advantage of foreign trade is that more wealth is produced and becomes available to the countries dealing with one another in the course of international commerce. However, although, all derive a benefit, the benefit is not uniform. The proportion in which the benefit of international trade is distributed among the countries depends on their relative intensity of demand for each other's goods.

*Question 10*—Discuss the organisation and problems of one of the following industries in India.—

(a) Cotton Industry.

(b) Sugar Industry.

*Answer*—When the Cotton Mill Industry was started on a large scale in India at the end of the last and at the beginning of the present century, it was concentrated in two centres of Bombay Presidency, viz, Ahmedabad and Bombay City and Island. The early concentration of the Industry in the Bombay Island has been governed by such factors as abundant supply of capital and credit facilities, the presence of cheap and speedy means of transport and the temporary growth of the demand for yarn from China which Bombay was in an exceptionally favourable situation to meet. Bombay was also initially favoured with an adequate supply of good cotton near at hand. The favourable situation of the city was also a considerable advantage from the point of view of importation of machinery, mills



store and coal. Lastly, the urge for industrialisation was great in Bombay than elsewhere on account of the agricultural backwardness of the Province. But feature of post-war development and particularly during the last decades in the textile industry has been the tendency to spread throughout the country rather than to concentrate in the Bombay Presidency. This feature has been in evidence particularly in Madras and Bengal. The reasons for such a tendency are not far to seek. Climate is now not more important a factor as it once was since it can be regulated in factories as desired by artificial methods. Cotton is at present grown extensively in several provinces. Capital is no longer shy in India and is forthcoming without much difficulty for the financing of undertakings having reasonable prospects of success. Again, as India is a country of long distances, freight charges have become an important factor in shaping the lines of industrial development; consequently, decentralisation rather than concentration is the present-day tendency in regard to the Cotton Mill Industry. Finally, labour, skilled and unskilled is available comparatively cheaper in other centres than in Bombay and Ahmedabad. For these reasons up country centres like Sholapur, Nagpur, Cawnpore, Delhi have rapidly developed the cotton mills.

Until the beginning of the present century, the principal products of the mill was yarn meant for the consumption of the Indian Handloom Industry and for export to China but the Chinese market was soon lost and the Indian Mills began to concentrate their energies on the production of yarn and cloth for home consumption. Consequently, there has been a great advancement in the weaving branch of the industry and at present there is in evidence a tendency to increase the manufacture of finer counts, a certain amount of long staple cotton being imported from U S A. and elsewhere for this purpose. The industry progressed rapidly from the eighteen-eighties onwards in spite of the temporary setbacks due to plague and draught, the rise of Japanese competition in India's foreign markets, exchange difficulty and high prices of cotton. During the war, the industry experienced unparalleled prosperity on account of the impossibility of obtaining imports from Lancashire and due to the Government patronage in respect of military requirements for cotton goods. Due, however, to the difficulty of obtaining machinery and plant few new mills were constructed, the existing mills, on the other hand, worked at top speed and obtained high profits. The Swadeshi Movement led by Mahatma Gandhi gave a further stimulus to the industry. Much improvement

has been made in the matter of spinning yarn of higher counts. The cloth produced in some cases is very superior and of much finer counts. The area of competition with imported yarn and cloth has now been extended. Three post-war years were years of boom for the Cotton Industry when huge profits were earned. In subsequent years, the industry, however, suffered from trade depression and excessive competition from Japan, in Indian markets. Not only Japan snatched away from India the Chinese market for Indian exports but she also invaded the Indian market itself with cheap yarn and piece-goods. The Indian Industry, however, was able to largely overcome this difficulty with the help of the protection it enjoyed since 1927. The Japanese competition also came to be regulated by the Indo-Japanese Trade Agreement which restricted the maximum quantities of imports of Japanese piece-goods into India on a quota basis, Japan undertaking the import of certain quantity of Indian Cotton against a certain amount of her exports of cotton goods into India.

*The War Years.*—After a continuous period of almost unrelieved gloom extending over a period of nearly two decades, culminating in measures being actively explored with a view to bringing about an organised curtailment of production throughout the country, the war in Europe which commenced in September 1939 opened up the prospect of a spell of prosperity for the industry. Following the cessation of trade with Japan, which happened to be the leading supplier of cotton textile to the East in December, 1941, the Indian cotton textile industry enjoyed a completely monopolistic position. It was faced with a steadily expanding demand from overseas, an increasing volume of war orders and growing domestic requirements for civil purposes stepped up by inflationary forces. The cloth production was stepped up from 4,012.4 million yards in 1939-40 to the record level of 4,870.6 million yards in 1943-44. Yet the industry was unable to meet the growing demand and the prices were pushed up to four times the pre-war levels.

In May, 1943, the Government of India issued the cotton cloth and yarn (control) order based on an agreement between the Government of India and the representatives of the textile industry. Its objects were to reduce prices and stimulate production by controlling the cost and supply of mill stores and by regulating the price of raw cotton and by superintending the distribution of cloth from the mills to the retailers. The control authorities were, however, faced

with a formidable task created by reduction in output due to coal shortage and *hartals* on the one hand and growing demand on the other. Consequently, though in the following two years, the prices stamped on the cloth were brought down by about 60% the full benefit was not passed to the consumer owing to widespread black market activity, mainly encouraged by illicit exports due to trade regulations and large scale hoarding as inflation hedge.

The latest supply position was reviewed by the Chairman of the Textile Control Board recently when he said: "In the calendar year 145 Indian cotton mills produced 4,687 million yards of cloth and 1,625 million lbs of yarn in 1944 and 4,715 million yards of cloth and 1,620 million lbs. of yarn in 1943. The loss in production in 1944 is primarily due to stoppages of mills for lack of coal or inferior coal. In 1945 a higher production might have been attained had it not been for a large number of spindles and loom hours lost through *hartals*, shortage of labour, shortage of raw materials, etc. It is estimated that the total quantity of cloth and yarn exported in 1945 would be approximately 387 million yards of cloth and 13 million lbs of yarn as compared with 434 million yards of cloth and 18 million lbs of yarn in 1944. Supplies of cloth and yarn for defence services in 1945 have amounted to 417 million yards of cloth and 25 million lbs of yarn as compared with 583 million yards of cloth and 28 million lbs. of yarn in 1944. The net available supplies of mill made cloth for civilian consumption in 1945 amount, therefore, to 3,883 million yards as compared with 3,794 million yards in 1944. Including handloom, it is estimated that the cloth available for the civilian population of the sub-continent in 1945 is approximately 14 yards per head per annum for a population of 400 million."

*Exports.*—The table below sets out the exports of cotton twist and yarn from the sub-continent to its chief export markets—

	1941-42	1943-44	1944-45	1945-46
	lbs	lbs.	lbs.	lbs
United Kingdom	3651838			
Burma	29165816			
Straits Settlement	2506320			
Hongkong	3881286			
Syria	1547100	14000	841360	482900
Others	49776205	18922952	16077053	14014041
Grand Total	90528563	18936952	16918413	14496941

The table below sets out the exports of cotton piece-goods to foreign countries

(In Thousands of yards).						
1940-41						
Burma	117706	61827				
Iran	536	7784	39658	8900	11565	5367
Iraq	5710	19608	77773	12750	25172	34063
Straits Settlements	24719	35133	...	...	...	...
Aden etc.	552	23108	41715	34460	52769	37089
Kenya „	45587	69337	42930	40589	28615	37833
Ceylon	27001	26273	45419	37646	33800	27585
Portuguese East Africa	5093	2301	2094	204	285	818
Others	109477	400584	439149	326788	260816	297755
Grand Total	335881	645855	688738	461337	423021	440510

In relation to the world cotton textile industry, the Indian industry ranks second from the point of view of spindles and looms installed. The position of the mill industry in the economy of the sub-continent will be evident from the fact that, at the present time, it consumes more than 70% of the total cotton crops directly gives employment to over 500,000 workers, and affords subsidiary employment to large numbers of persons who are engaged in various trades which directly depend for their existence upon the cotton mills industry.

India is the birth place of the Cotton Industry and the place of the Cotton Textile Industry in the national economy of India is second only to that of agriculture. Alike in capital sunk in the industry and the volume of employment which it creates and the net addition to the total wealth and income of the country, it has no rival among our industries. India is rich in her cotton resources; she has the requisite labour to supply, for the Cotton Textile Industry there is no dearth of industrial capital, and captains of industry who are prepared to shoulder the risks of the venture are forthcoming. India with its vast population, affords a great market for the

home products. The prospects of the industry are not dark but, of course, the industry requires to be organised on sound lines and competition with older and strong foreign countries is kept at arm's length by protected duties of such like measures. There are also certain other matters which deserve the close attention of the mill-owners, if they desire to consolidate their positions for future emergencies. Firstly, the benefits of the present revival should be utilised in the set purpose of stabilising the industry on a finer basis. Frittering away higher earnings on bumper dividends and bonus without giving any thought to the uncertainties of the future will have to be avoided. The lessons of the past are too poignant to be retold. Secondly, there is the question of the exploration of the possibility of corporate advertising to 'boost' Indian Mill Cloth. The creation of a central publicity organisation financed by leading Mill-owner's Organisation mainly for press advertisements and propaganda purposes should be one of the first efforts for the drive towards prosperity.

The industry suffers from a basic weakness. As in 1919 so in 1948 it depends on foreign countries for supply of textile machinery, spare parts and oils, chemicals and even long stapled cotton.

The industry needs rationalisation in many respects in the use of improved machinery improved labour efficiency, better purchases of raw materials, in the standardisation of products and in the marketing, management and finance of the industry.

There has been regional specialisation in the cotton industry. Bombay produce cloth mainly of light texture from medium and higher count yarn. Ahmedabad has specialised in Dhatis and Saris. Madras produces high class cotton coatings, and bleached shirting, and drills. Southern India has developed a large spinning industry. Mills in northern India produce mostly coarser cloth.

The last war has no doubt disturbed this specialisation. It is suggested that mill products should be standardised and certain mills should be asked to produce certain quantities. Efforts should be made at simplification, specialisation and standardisation of products. Duplication of work should be avoided and uneconomic machinery eliminated.

Bombay had the initial concentration of the industry although in this century the textile industry has spread to the interior. A time has come when the industry should be further decentralised if it is to be put on a healthy basis. Now that hydro-electric schemes are being developed all over the country and cotton is grown practically everywhere the industry can develop in areas with large and prosperous population.

Labour problem is the most difficult to tackle. Labour has grown more conscious, economically and politically during the war years. The worker is not satisfied with a living wage. He wants a share in the management and ownership of the concern in which he works. No doubt labour was exploited in the past by the industrialists and their own personal benefits. Steps should be taken to ensure that labour is treated fairly well. But labour should also be in a reasonable frame of mind. They should "work more and get more" and should not "go slow and expect more". They should realise that rights and liabilities should go together.

Lastly, the industry should devote attention to the development of technical education and education in the art of mill management. So far finance without the accompaniment of technical education has dominated the industry. This gap must be bridged over as early as possible.

Planning should be on all-India basis and the distribution of new plants and extensions of the existing plants should follow territorial divisions of India.

(2) Sheltered behind an adequate tariff wall, the Indian sugar industry has made phenomenal progress in spite of the economic depression. The main difficulty in the way of establishing new large factory industries during recent years of depression has been that finding a party or company able or willing to face financial risks involved. In the case of sugar industry, the risk was removed by tariff legislation. Besides the duty, various other special advantages—consequent upon the depression—have helped the rapid growth of the industry. Low price of land and materials as also of machinery—all these factors have contributed to the remarkable development of the industry. The year 1930-31 is

a landmark in the history of sugar industry. It was in this year, that the question of protection of the Sugar industry was referred to the Tariff Board by the Government. From 13th September 1931 an import duty of Rs 9-11-0 per cwt was imposed on all imports of sugar—a protective duty of almost 200% on the price at which sugar was then being imported from Java.

The progress of the industry after the grant of protection has been phenomenal, as can be seen from the fact that while in 1932-33, the number of sugar mills was only 57 it increased to over 137 in 1935-36 and to 151 in 1943-44 but came down to 140 in the following years.

The following table shows the number of cane factories working in India, including States, and production of sugar from cane factories, gur refineries, khandasari, net import of sugar in British India and import in Kathiawar ports during the last 15 years.

Year (Nov. Oct.)	No. of cane Factories working in India.	Cane factories Production (Nov.-Oct.)	Sugar refined from Gur (Jan.-Dec.)	Khandasari Conjectural estimates (Nov.-Oct.)	Total Pro- duction of Sugar in India (Nov- Oct.)	Net Imports (Excluding Re-exports) of sugar in British India (Nov.-Oct.)	Imports of sugar in Kathiawar Ports (Nov.- Oct.)
		Tons	Tons	Tons	Tons	Tons	Tons
1932-33	57	290,177	80,106	275,000	645,393	321,081	68,649
1933-34	112	454,000	61,900	200,000	718,900	233,366	87,094
1934-35	130	578,100	43,500	150,000	771,600	197,775	113,364
1935-36	137	932,100	47,900	125,000	1,105,000	86,962	45,218
1936-37	137	1,111,400	25,600	100,000	1,237,000	11,160	12,870
1937-38	136	930,700	17,200	125,000	1,072,900	9,410	12,238
1938-39	139	650,800	14,700	100,000	762,500	254,400	77,000
1939-40	145	1,241,700	26,500	125,000	1,393,200	34,093	32,743
1940-41	149	1,095,400	44,700	2,000,000	1,340,100	27,934	15,263
1941-42	150	778,100	20,400	100,000	898,500	23,843	6,608
1942-43	150	1,070,700	7,800	214,000	1,292,502	8	..
1943-44	151	1,216,400	7,700	150,000	1,374,000	14	..
1944-45	140	953,500	6,400	125,000	1,084,900	30	..
1945-46	145	944,800	4,000	117,000	1,065,800	..	..
1946-47	141	928,200	4,000	110,000	1,142,200	..	..



The sugar industry was controlled since 1942 by the Government of India, and this control was maintained all throughout the period of the war and upto 10th December, 1947, when control over sugar was lifted. Along with sugar, production of gur was also controlled. While the control succeeded to a certain extent in achieving its object, namely, check over indiscriminate rise in prices, it failed to increase production of sugar, although it was the avowed object of the Government to increase production. With the decontrol of sugar and the fixation of higher prices of sugar by the Government of India, with effect from the 1947-48 crushing season, in order to enable them to enhance the minimum price of the raw materials, namely, sugarcane, from Re. 1/4/- per maund to Rs. 2/- per maund in the U P. and Bihar, principal sugar-producing provinces of the country, it is hoped that larger quantities of sugarcane will be available to sugar mills for crushing, and that consequently production of sugar will increase in order to meet the requirements of sugar in the country which have been steadily going up since the last few years.

*Capital Outlay.*—The capital invested at the present time in the sugar industry is roughly of the order of 35 crores of rupees. The Sugar Panel estimated that the total cost of machinery required for (a) fuller exploitation of the existing capacity of the sugar factories, (b) enhancement of the capacity of the existing small plants, and (c) construction of 20 new factories of 1,000 tons of cane per day crushing capacity, would be about 11-12 crores of rupees. If to this we add the cost of establishment 25 new factories decided by the Government of India while reviewing the recommendations of the Sugar Panel in 1947, the total cost would be about 22 crores of rupees for the machinery.

A large bulk of the existing sugar machinery had been imported from various countries, e.g., U K., Germany, Czechoslovakia, France, etc. but it is impossible that in the years to come certain units of the sugar machinery can be fabricated in India, and if the new plants are fabricated in India, it would be of great help to the engineering industry of the country as well.

*Import Possibilities.*—Although production of sugar in India at the present time is slightly less than its estimated consumption, it is not likely that there will be any large-sized import of sugar from foreign countries, firstly, because production of sugar in the world is at present smaller than the

consumption, there are difficulties regarding currency and exchange, and Java which used to be the largest supplier of sugar in the past, is producing at the present time sugar in negligible quantities. Judging from the reports about the economic and political conditions in Java, it would take at least three years before Java is able to produce the quantity of sugar it did in the pre-war years, namely, 15,000,000 tons and indeed may take a longer period still for Java to rehabilitate its industry to its previous size due to the ruination brought about the World War in the economy of the industry. There is, therefore, little danger of large sized imports of sugar from foreign countries, but it appears that protection to the sugar industry will have to be continued for some time because any disturbance in the present protection would adversely affect the cultivation of cane in India. The Tariff Board of 1947, in their report, while recommending protection to the sugar industry, observed that protection to the sugar industry was in effect protection to the sugarcane cultivation in India which was an integral part of India's agricultural economy. The extent and the speed of the development of the sugar industry in India will depend to some extent upon the attitude of the Union of Pakistan for developing the industry within its Dominion and the arrangements which they make for getting their requirements of sugar in the meanwhile, i.e., from India or foreign countries.

*Problems of the Industry.*—While a considerable improvement has been made in the yield per acre in the last 15 years much remains to be done. Our averages yield per acre is 367 maunds as against 1,500 maunds per acre in Java and Cuba. Our holdings are small and scattered. The facilities of irrigation, manure and transportation between field and factory are not what one finds in these Islands. Every effort must, therefore, be made to improve the quality of cane and the total yield per acre. Researches should be carried on to evolve early and late ripening varieties of sugarcane. This will give longer occupation to our mills and mill hands. If possible experiments should be made particularly on newly acquired waste land, to have field and factory in close proximity.

India produces over 54 million tons of cane. On this 61 per cent is utilised in the manufacture of gur, 4.5 in the manufacture of khand, 17.4 in the manufacture of factory sugar and 16.2 for non-industrial uses. It is estimated that about 10% juice is wasted in the manufacture of gur owing to inefficient cane-crushers. Converted in terms of a money it

amounts to a loss of about Rs. 2½ crores per year which is more than the total cost of replacing the existing cane-crushers. The Government should seriously consider this problem.

Another problem of serious nature is the want of correct price parity between the price of cane, gur and sugar. At one time while white sugar was selling at -/9/3 per seer gur could not be obtained at /12/- per seer in most of the markets. Price of cane should be fixed as to guarantee a fair price to the cultivator. The Government should not allow the vicious circle of rising prices to continue any longer. Before the industry can attain a solid position it has thus to solve many problems. There are problems connected with sugarcane like improving the quality of cane, growing early ripening and late ripening varieties. The utilisation of bye-products, namely, molasses and bagasse is also a pressing problem. Though unity and joint action have been realised in marketing much still remains to be done.

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1939

*Question 1*—Examine the economic implications of fluctuations in the general level of prices.

*Answer*—Fluctuations in prices are of the greatest social significance and exercise immeasurable influences on the production and distribution of wealth. It has been said with a great deal of truth that the instability of the general level of prices following changes in the value of money is the greatest economic drawback of modern times. The present economic system is based upon a price structure and long term contracts resting on the assumption that the value of money will remain unchanged. The changes in the price level create widespread economic disturbances. Both rising as well as falling prices are bad to society. Rising prices breed optimism. They lead to over confidence, dangerous speculation and extension of business which may not be justified by the actual conditions. Falling prices have the opposite effect. Appreciable changes in the general price level disturb the even basis of trade and industry as production is rendered doubtful. The changes in price level also create instable equilibrium in society thus causing serious disturbances in the relative distribution of wealth amongst the various sections of the community and benefit some classes at the expense of others. How these various classes are affected, to know this the readers are referred to answer to *Question No. 6—Economics, 1937*.

*Question 2*.—Distinguish between the "monetary" and the "real" cause of the trade cycle. Which of them do you think constitutes the correct explanation?

*Answer*—A trade or business cycle is perhaps the most baffling economic phenomena of modern times. If the cause or causes could be elucidated and placed beyond the region of doubt many other economic problems would be solved. But the difficulty is that economists are not agreed as to what are the causes of a commercial crisis. The majority of present day economists offer one or the other of two explanations. One group stresses the monetary influences operative in industry and commerce. Purchases, it is said, are made with borrowed capital, that is, bank loans and advances. When people expect a rise they buy in order to sell, and their action strengthens the upward tendency in prices which in turn justifies their action. But this policy is made possible by the readiness of banks to grant accommodation at a low

rate. There is no limit to bank credit and so long as capital and labour can be remuneratively employed production continues. A speculative boom is thus superimposed upon the production boom and prices rise rapidly. Then comes the period of uncertainty. Prices fall, banks withdraw financial helps, production ceases, many firms otherwise solvent come to grief for want of money and a financial crisis occurs. Banks after allowing credit to expand to a certain point suddenly contract it; credit stringency causes business stagnation. It is thus the defective working of the monetary and banking structure that puts the industrial system out of gear. The speculative boom, according to the advocates of the monetary policy could be avoided if the banks refused accommodation beyond the amount necessary to increase production to the limit imposed by the available industrial equipment.

Other economists favour what is called the psychological theory of cyclical fluctuations or the Sun spot theory or Over-production theory. They criticize the monetary theory on the grounds that "the fundamental causes of fluctuations arise out of the conditions of industry itself rather than finance, and that although monetary influences are important, they are not the primary cause of fluctuations. Credit and currency inflation make a boom possible and condition the extent of boom, but they do not cause it. A more important objection is that the trade cycle, being a world phenomenon, cannot, on the one hand, be attributed to the internal conditions of one or two countries, nor, on the other hand, can it be remedied by isolated attempts at monetary reform. International and not national action is clearly necessary if international stability is to be achieved."

Prof. Pigou asserts that dominant over all such extraneous factors as harvests, inventions etc., the *real* cause of a cyclical fluctuation in trade is the state of mind of the leaders of industry and commerce. "The attitude of these persons towards the signs of the times does not remain constant, but varies from period to period between errors of optimism and errors of pessimism. In good times they become over-confident, exaggerate their prospects, and expand their investments farther than a true forecast of their profitableness would warrant. After a while when the goods, for the production of which they have made preparations, are ready for the market, they find that the demand for them is less than they had looked for; they suffer losses, and these losses react on their state of mind, causing them now to under-estimate the

prospects of investment, just as previously they had over-estimated them. If the minds of 'business' men had moved independently of one another, their several movements would, indeed, tend to cancel out, and though the different parts of industry might vary a good deal relatively to one another, industry in the aggregate would not vary much. As a matter of fact, however, the states of mind of different business men do not move independently—the swing from the one sort of error to the other is a common general swing—a sort of crowd-movement. The reason for this is partly that states of mind are infectious, and that the people who control business live close together in cities. partly that, in the modern world, different business concerns are bound together by a network of orders and of credit relations. On account of these things, moods of optimistic error and, subsequently, moods of pessimistic error tend to move in single waves over wide areas, thus bringing about those large changes in industrial activity generally which characterize modern trade cycles.

The two theories seem to be contradictory but they can be reconciled. There is no doubt that the psychological factor is important. Businessmen are influenced by each other. mental states are infectious. We find that the actions of the leading competitors in a trade influence the actions of the smaller firms, who fear that their powerful rivals know more than themselves, and will steal a march upon them if they do not follow their example. We find, moreover, that the estimate of the prospects of one industry spreads rapidly to the ancillary industries, and influences opinion in the latter. Finally, the publication of information in newspapers and journals helps to spread a feeling of hope or fear in a community which realizes the interdependence of the many parts of the economic system.

The trade expansion would not be possible without the supply of requisite money and, when production has reached its limit, the supply of money by banks is an essential preliminary to a speculation boom. It does not produce such a boom—which is produced by psychological influences—but it renders such a boom possible. From what has been said above it is clear that the fluctuations in trade and industry may be attributable to climatic influences or to the vagaries of human nature, but the conditions which eventually culminate in a boom and result later in a crash are due almost entirely to financial or monetary causes.

*Question 3.*—Describe briefly the essential features of different forms of the gold standard.

*Answer.*—See answer to Question 2, Economics, 1937.

*Question 4.*—Examine the nature of bank credit. Is there any limit to its expansion ?

*Answer*—The banks are the biggest lenders of credit and the superstructure of credit is built by them on the very slender foundations of cash. Where does the cash come from ? The bank does not provide the cash from its own pockets nor does it trade on its own capital. The banker's business has been wittily described as "your money and my brains". He says to the public "I take your money and make use of it to earn profits for myself and at the same time I can render you service". It is the deposits kept with the bank by people that furnish the cash with the help of which credit is created. In advanced countries people know that it is wasteful to keep money in their own coffers. They keep a bank account and will carry a cheque book. All their savings go into the banks, so that the money which would have otherwise lain idle can be utilised by the banks and made the basis of credit. The little savings of individuals go to make up a large volume of cash and out of this large national volume—a volume of credit and purchasing power is created. It is out of the people's savings that credit is manufactured. The question arises how it is possible for banks to lend other people's money perhaps for a long period, and pay the claims made upon it on demand or at short notice. Depositors do not draw upon a bank at one and the same time. Many people use the banks simply to store their wealth and do not continuously withdraw if for business or for other purpose. A prudent banker knows what amount of cash he should keep in his hand to meet the drawings upon him of his customers. The surplus amount of deposits over this cash is loaned by him. Banking is thus conducted on the assumption that at any time there will be a certain surplus of cash deposited over cash required and that this surplus can be loaned out at a profit.

There is another way in which credit may be created by banks but this theory is more of a hypothetical character than of a practical nature. It is said that the loans made by a bank help it to create further credit. The man who borrows from bank wants ordinarily purchasing power and not money. When a loan or overdraft has been granted by a bank the amount loaned is left with the bank itself or with another

bank. These deposits enable the bank to allow further advances. The way in which these 'credit deposits are created will be made clear by the following illustration. A bank finds that it can safely lend, say, sixty per cent of its deposits (cash deposits), keeping as its banking reserve (till money as it is called) the remaining forty per cent and some extra reserves in gold, in hard cash or liquid securities i.e. securities which can be easily sold and converted into coin. Thus, if the loans a bank gives amount to Rs 60,000, it finds that the Rs 60,000 are again deposited with it—an instance of credit deposits. Knowing that amount will not be withdrawn by those to whom it has been credited, the bank can again advance to businessmen Rs. 36,000 on the strength of the deposits made by its debtors. These Rs 36,000 again become deposits and on the strength of these further advances of Rs. 21,600 can be made to new businessmen requiring accommodation. That this sort of banking practice is impossible is obvious, though to some extent it may look feasible. Besides the above two methods, a bank, which enjoys the privilege of issuing bank notes, may lend their credit in the form of promises to pay on demand without interest on the notes issued by it.

One point should be borne in mind in connection with the bank credits. The nature of bank credit limits its use to borrowers whose need of purchasing power is only temporary. A commercial bank cannot lend on long-time paper to any considerable extent without losing that quick control over its assets that is indispensable to its solvency, since nearly all of its liabilities must be discharged on demand. Its loans must be on call or short-time paper, and this confines its services to businessmen whose transactions are of such a nature that they can count confidently on ability to repay, after a brief interval, what they have borrowed. It is due to this that bank's loans assume a variety of forms depending upon the kind of security deposited and the conditions as to the payment of interest. The simplest form is the loan on the personal note of the borrower secured only by his individual name. This is called "a single name paper". If it is endorsed by another it is called "a two-name paper". Sometimes these notes are secured by pledges of stocks or bonds. In this connection they are called "collateral securities". If such notes are not paid when they fall due, the bank is at liberty to sell the pledged securities.

In addition to lending on paper created for the purpose of the loan, banks lend by discounting notes and bills of



exchange created in connection with ordinary mercantile transactions. By discounting a bill, a bank virtually lends its customers the face value of the note less the discount which is in this case the interest.

Besides, differing in their forms bank loans differ as to the condition of payment. In this connection "call" or demand loans, short-time loans and long-time loans must be distinguished. Call loans are payable at any time at the will of either lender or borrower. Short-time loans are loans which "mature", or fall due within thirty, sixty or ninety days. Next to call loans, these are preferred by a commercial bank, which likes to have its resources as completely under control at any given time as possible. Long-time loans are loans that run for six months or more and are made more frequently by savings banks, trust companies and private bankers whose obligations to depositors do not usually call for repayment on demand. The prudent banker makes the combination of these various kinds of loans that will secure for his bank the largest average rate of return without so tying up its funds that they cannot be quickly converted into cash to meet an emergency.

### **Limits to the Issue of Bank Credit**

There are definite limits to the powers of banks to increase the volume of credit. The banks will cease to create credit at the point where the proportion of their cash to liabilities reaches the figure which is sometimes described as a bank's "traditional" ratio. This is not a fixed one but varies with different banks and is necessarily determined by the nature of the business and the individual experience. It also varies in accordance with the general state of confidence and the state of trade. In all cases, however, it is essential that a reserve must be maintained which is sufficient enough to meet all demands, normal and abnormal, otherwise a great panic may result amongst the customers leading possibly to the failure of a bank. This requirement sets definite limits to the bank's ability to expand credit.

*Question 5.*—Critically review the history [of the Indian rupee between 1893 and 1914.

*Answer*—The Indian monetary system remained one of silver monometallism (silver standard) upto 1893, when, on the recommendations of the Herschell Committee, the Indian mints were closed to the free coinage of silver on private account and the gold value of the rupee was fixed at 1s. 4d. because this was the average value of the silver

content of [the rupee at that time This step was taken to meet the grave financial embarrassment of the Government of India arising from the gold exchange value of the rupee since 1871. The Gold value of the rupee which was about 2s. in 1871 had fallen to about 1s 2d. in 1892. The falling rate also effected adversely the foreign trade of India and investment of foreign capital in the country. The immediate object of the closing of the mints was to raise the value of the rupee by restricting its supply. This was not realized in practice at once. The exchange value of the rupee began to fall below 1s. 4d. and by 1896 it touched 1s. 6d. The reasons were many

(1) A new trade depression began in 1893 which lasted until about 1896.

(2) The apprehension caused in the minds of the people brought out the hoarded rupees into circulations.

(3) Rupees from outside British India also sought the Indian market.

(4) The year 1893 [also witnessed a great monetary panic in America. The situation became so embarrassing that the question of Indian Currency was referred to another Committee known as the Fowler Committee.

The Fowler Committee decided to recommend the establishment of an effective gold standard because uncertainty would continue as to the ultimate success of the gold standard unless steps were taken immediately. Their recommendations were as follows —

(1) The British sovereign should be a legal tender and current coin in India, as the Committee could not conceive that a gold standard was consistent without a gold currency in circulation, and that the silver rupee should be maintained as unlimited legal tender until India was sufficiently saturated with gold—an arrangement which virtually amounted to the establishment of a Limping Standard analogous to that of France

(2) The Indian mints should remain closed to the unrestricted coinage of silver, but should be opened to the unrestricted coinage of gold.

(3) The ratio between the rupee and the pound sterling should be 15 rupees to the pound

(4) With regard to the convertibility of the rupee no legal obligation to give gold for rupees should be accepted.

(5) Any profit on the coinage of rupees should not be credited to the revenue or held as a portion of the ordinary balance of the Government of India, but should be kept in gold as a special reserve.

These recommendations were accepted by the Government of India and legislation was undertaken to give effect to these recommendations.

After 1898 economic conditions in India began to improve and a demand for currency manifested itself. The attempt to push gold into circulation to satisfy the currency needs of the country did not meet with any success. The result was that gold began to accumulate in the Paper Currency Reserve. The demand of the public had to be met in rupees and notes. Instead of establishing a gold standard with a gold currency in the country, Government drifted towards the adoption a standard known as the Gold Exchange Standard. The Gold Exchange Standard was based on the scheme put forward by Mr. Lindsay.

The Gold Exchange Standard was introduced in 1900, the chief features of which may briefly be summarised as follows :—

(1) Though coins of both silver and gold were unlimited legal tender, the local currency mostly consisted of silver coins.

(2) Gold was made available for foreign payments at a certain maximum rate in exchange for local currency.

(3) The system of free coinage of silver was suspended in order to sever the connection between the value of silver as currency and silver as metal and to make the silver currency token coins.

(4) The local currency was redeemable in gold or in bills on foreign centres and thus a fixed value in gold was given to the silver currency.

(5) This process of redemption implied the formation of a gold reserve to provide the required gold for foreign remittances.

## The Crisis of 1907-08

The American monetary crisis of 1907 as also the failure of harvests in India put the Gold Exchange Standard System under a severe test. The Indian exchange showed signs of weakness and demand for gold remittance manifested itself. This demand was met by the sale of Reserve Council Bills and in the course of a few months improvement was effected in the Indian exchange. But though the system stood this crisis very well, it exposed certain weaknesses in the working of the system. In the first place, the hesitation shown by the Government of India in the matter of the sale of Reverse Council Bills introduced an element of uncertainty. Secondly, the hesitation showed the inadequacy of the Gold Standard Reserve for supporting the Indian Exchange.

However, the exchange rate was again restored to *1s 4d.* because of the contraction of currency that was brought about by the sale of Reverse Councils and the fall in prices leading to an increase in India's exports in later years. The Gold Exchange Standard System then continued smoothly till 1916 when it had to give way on account of the abnormal rise in the value of silver.

The currency system of India became the subject of severe criticism and the Indian public persistently demanded the introduction of gold standard and gold currency in India. In 1912, a commission was appointed under the Chairmanship of Sir Austin Chamberlain to enquire into the Indian currency system. This Commission approved in unhesitating terms the working of the Gold Exchange Standard in India. They pointed out that under this system India got to the fullest extent a gold standard without a gold currency in effective circulation and they emphasised its cheapness. They urged that gold in reserve was far more reliable in supporting exchange than gold in circulation.

**Question 6**—What is the function of a Money Market? Does the Indian Money Market perform this function satisfactorily?

**Answer.**—The term "Money Market" is used in two senses; market for short term credit and capital market. In the former sense it is the place where the idle or surplus funds or the floating cash of the important financial

institutions of the nation seek temporary employment in buying such short-dated securities as bills, treasury obligations, and other safe and liquid short-term obligations such as commercial paper, are lent to the stock-brokers on an average for a long period of seven days as money at short notice or on day-to-day basis as call money. Bank bills, treasury obligations, trade bills and stock exchange loans constitute the chief means by which these short term loanable resources find an outlet. The term is used in this sense by bankers, businessmen, dealers on the stock exchange, and by the Government when issue of Treasury Bills for temporary accommodation is involved. In the second sense the term means capital market and refers to the vast array of specialising institutions such as banks, stock exchanges, bill-brokers, acceptance houses, trust and finance companies and other specialising credit agencies whose main task is to supply the needed stock of money, be it State or commodity money, or substitutes for the legal tender State money known as representative money or bank money. They bring about at the same time an economical and safe transfer of it to needy borrowers, i.e., make loans to industry, trade and the Government for meeting their demand for working capital or loan capital of a more permanent character. This is the broader and more comprehensive sense of the term and the Money market in this sense includes not only the short term loan market and the bill market but the foreign exchange market and the investment market. Each constituent member of the money market performs its own functions although all of them deal in a common commodity-money, which is bought, (borrowed) and sold (lent) for varying periods, short and long and for various purposes. The banks perform a double task. They help in the accumulating of the monetary pool or stock and transferring the same from the lethargic depositor to the go-ahead and economically ambitious borrower. The bill broker provides a valuable link between the general public and banks. It is his function and that of a Discount House as well to guarantee commercial credits. The existence of an open discount market as a part of larger money market and a rediscounting agency as that of a Central Bank enable these specialists to confine themselves to bill broking as their sole occupation. The main concern of Accepting Houses is to open credits, accept bills and prepare them for the money market. The Stock Exchange is the recognised market for investment. In the foreign exchange market domestic money is converted into foreign money and future money, into spot money. The Central

Bank is the leader of the money market and its function is to act as a regulatory authority. It controls the credit policy of the country by manipulating its discount rate and the bank rate and by conducting what are known as open market operations. The money market thus constitutes the ground-work of the country's national finance.

The above analysis of the functions of a money market make it clear that no such organisation exists in India. In the first place, there is the sectional organisation of the Money Market in India and weak co-relation between its various parts. The Imperial Bank of India, the Exchange Banks, the Indian Joint Stock Banks, the Co-operative Banks and the indigenous bankers have each carved out for themselves respective spheres of their own and there is very little encroachment of a serious nature on the work of one kind of credit agency by another. The position was most unsatisfactory before the establishment of the Reserve Bank. But by far the most serious rift in the market is the unfortunate divorce between the indigenous bankers and the central money market although the former meet about 90 per cent of the banking needs of the country. It is due to this reason that there does not exist the same intimate connection between the Bank Rate, Bank's deposit rates, rate for money at short notice and the rate for Bills as there is in England. Another serious deficiency of the Indian Money Market is the lack of a Bill Market. This makes short term investment by bank difficult. Most of the bills with the banks are Treasury Bills. There is no quick and free flow of funds in the different parts of India with the result that the Bank rate is no index of monetary condition in the country as a whole. One more direction in which the Indian market fails to perform its function properly is the supply of money. There is lack of elasticity in the credit system of the country. Seasonal expansion and contraction of currency is not quick and automatic and there are frequent complaints regarding the unresponsiveness of our currency to the needs of trade. The establishment of the Reserve Bank of India equipped with the right of holding banking reserves in the country, issuing notes, of discounting bills and promissory notes for scheduled banks, of making advances to them and of conducting open market operation is calculated to relieve monetary stringency and make our Money Market elastic.

With all these defects the Indian Money Market offers no contrast to the well-organised market of the world, as the London Money Market, and is unable to perform properly the functions assigned to a money market.

## SECTION II

*Question 7.*—What are “quotas”? How have they been used for regulating the trade policy of India?

*Answer.*—It has been found by recent experience that tariffs may be largely ineffective as a method of restricting imports from countries with depreciating currencies. For this reason it has become a common practice to regulate imports by the quota system, which prohibits imports in excess of a given amount in a given period. The country employing the system may either restrict the total imports of a given commodity to a specified amount and allow foreign producers to compete among themselves for that trade, or it may specify the maximum amount that may be imported from each producing country. It is clear that such a system may only be employed in respect of a commodity which is also produced within the importing country: It is a method of protecting the home producer. It is also clear that the system obstructs the operation of other economic forces, and thereby, like tariffs, prevents the “law” of comparative costs from producing its full effect. Its action in this direction is more effective than that of tariffs. Recent tendencies suggest that the quota system is likely to be used in the future to an increasing extent, partly as a substitute for a tariff and partly in addition to a tariff upon the commodity concerned.

The Government of India did not fail to realise the significance of the Quota System and has adopted it in its fiscal and commercial policy. Some of the recent Trade Agreements were based on Quota System. For example, the Indo-Japanese Agreement (1934) prescribed a system of quotas for the imports of Japanese cloth into India and the export of raw cotton from India. Under this arrangement Japan was allowed to export to India in any cotton piece-goods year (i.e., the year beginning on 1st April) 325 million yards of cloth provided she purchased one million

cotton bales from India in any cotton year (i.e., the year beginning on 1st January) This was the basic quota The New Indo-Japanese Trade Agreement (1937) was based on the system of quotas The annual basic import quota of Japanese piece-goods was reduced, owing to the shrinkage of the Indian Market following the separation of 'Burma from India, from 325 million yards to 283 million yards against the purchase by Japan of Indian raw cotton one million bales.

**Question 8**—Examine the relative merits of tariffs and bounties as instruments for promoting the growth of industries in a country.

**Answer.**—The use of tariffs for promoting the growth of industries of a country involves the imposition of heavy customs duties on the imports of the commodities, the manufacture of which is to be encouraged in the home country. As a result of the imposition of such customs duties the importers of the foreign commodity are, generally speaking, forced to sell their commodity at a higher price. If the measure is to be effective, the tariff must be sufficiently high and, therefore, the price of the imported commodity must be sufficiently high for the domestic manufacturer of the same commodity to sell his product at a reasonable profit Thus the production within the country of the imported commodity becomes profitable and, therefore, is taken up by the domestic entrepreneur In this way the growth of industries in the country is promoted by means of tariffs.

Bounties are money subsidies given by the Government to domestic manufacturers of commodities, which are also exported, in case where the cost of production, including normal profit, of the domestic substitute is higher than the price at which the foreign commodity is sold in the country. Bounties are continued as long as the period is necessary for the domestic industries to obtain the ability to compete with the foreign industry Thus bounties can be used for promoting the growth of industries in a country As regards the relative merits of tariffs and bounties, it must be pointed out that in the case of tariffs the domestic price is raised with the result that the manufacture of the commodity within the country becomes profitable and the entrepreneur is attracted to establish the industry within the country. In the case of bounties the domestic industry is first to come into existence, even though it may have to incur losses in



doing so, before it can be protected by the help of bounties. It is, therefore, natural that tariffs will be a quicker way of promoting the growth of industries rather than bounties. Then again tariffs do not involve a burden on the general tax-payer but only on the consumer of the commodity, the manufacture of which is to be protected, whereas the bounties fall on the general tax-payer and involve an actual payment from the revenues of the State. It is, therefore, easier to get the legislature to accept tariffs rather than bounties. This also makes the tariff a better instrument for promoting the growth of industries. As against these considerations it must also be pointed out that when an industry is given a bounty, there will be more vigilance, on the part of the State and speedier attempts will be made by the industries in question to obtain efficiency, whereas when tariffs are instituted they tend to become permanent and there is no incentive on the part of the State to vigilantly watch the career of the protected industries. It does not mean, however, that tariffs do not constitute an easier and speedier instrument than bounties for promoting the growth of the industries in the country, only, when tariffs are instituted, care must be taken to see that the protected industry attains maximum efficiency as early as possible.

*Question 9*—Comment briefly on the changes that have taken place in the direction of India's foreign trade in post-war times.

*Note.*—Here War has reference to the First Great War of 1914-18.

*Answer.*—The following table will serve as an introduction to a discussion of the post-war development in foreign trade.

*Value in Crores of Rupees.*

Year	Imports.	Exports.	Net Exports.
1919-20	221 7	336 02	+ 111 32
1920-21	347 53	267 76	- 79 80
1921-22	282 59	248 65	- 33 94
1922-23	246 19	316 07	+ 69 88
1923-24	237 18	363 37	+ 126 19
1924-25	253 37	400 24	+ 146 87
1925-26	236 00	386 82	+ 150 82
1926-27	240 82	311 05	+ 70 23
1927-28	261 33	330 26	+ 68 73
1928-29	268 40	339 15	+ 75 75
1929-30	249 71	318 99	+ 69 28
1930-31	173 06	226 50	+ 53 44
1931-32	130 04	161 20	+ 31 16
1932-33	135 02	136 07	+ 1 05
1933-34	117 31	150 23	+ 32 92
1934-35	134 59	155 04	+ 20 45

The early post war was characterised by a trade boom caused by the removal of many of the war-time prohibitions on exports as well as a gradual resumption of commercial intercourse with enemy countries accompanied by an improvement in the freight position. There was also a brisk demand for Indian produce on the part of the Western Countries for the reorganisation of their industries. The revival of trade, especially on the side of exports, would have been even more striking but for the railway congestion in India, high prices, labour troubles, unstable foreign exchanges, the rise in the exchange value of the rupee and the continuation of the restrictions on the export of cereals owing to the failure of the Monsoon in 1918-19. The boom was, however, temporary and there soon appeared indications of a slump. Great Britain, the United States and Japan became glutted with Indian produce, and there was consequently a considerable slackening of the demand on their part. The countries of Central Europe which had been a valuable market for Indian export during the pre-war period, no doubt, wanted Indian products but could not purchase them due to their shattered resources and reduced purchasing power. The crisis in Japan prevented exports of cotton to that country. The ill-fated attempts of the Government to stabilise exchange at 2s on the recommendation of the Babington-Smith Committee further paralysed the already weak export trade. The import trade, on the other hand,

expanded rapidly. India's import requirements had been starved during the War and orders for machinery and other manufactured goods placed during the war now began to be carried out and goods commenced to pour into the country. The high exchange value of the Rupee also gave a stimulus to the import trade and orders were placed for immense quantities of manufactured goods. There was a heavy balance of trade against India in 1920, which continued into the next year. After the year 1922-23 there were signs of recovery and so far as the export trade of the country was concerned the trend towards the restoration of normal conditions was continuously in evidence till the year 1929-30. The conditions which favoured the progress towards the gradual recovery were the stabilisation of the European currencies and the settlement of the reparations question. The advance continued into the year 1928-29 only to be followed, however, by a depression world-wide in scope and unprecedented in magnitude. The increase in the total foreign trade after the year has been, however, due to the rise in the price of the commodities. So far as the volume of the trade measured in goods is concerned it had not reached the dimensions of 1913 upto 1927-28. The year 1928-29 was the first year after the pre-war year when figures of import and export trade exceeded the pre-war figures. The following figures compiled on the basis of the declared values in 1913-14 give an idea of the changes in the volume and course of Indian foreign trade.

*In Crores of Rupees*

	1913-14	1922-23	1924-25	1926-27	1928-29	1929-30
Imports	183	138	137	156	190	189
Exports	224	214	250	228	260	263
Trade excluding re-exports	427	352	387	384	450	452

  

	1930-31	1931-32	1932-33	1933-34	1934-35
Imports	157	143	152	146	172
Exports	235	200	176	209	216
Trade excluding re-exports	392	343	338	355	388

The war brought about an important change in the direction of India's foreign trade. The share of the United Kingdom fell during the war period, while that of Japan and U. S. A increased considerably. Japan made wonderful progress in India's import trade. In 1899, imports from Japan were quite insignificant, averaging less than 3 lakhs annually. In 1917-18 the value of imports from Japan was 400 per cent above the pre-war quinquennial average. The quantity of cotton goods alone was 30 times the quantity imported in the pre-war period. The price factor has in recent years been responsible for drawing large percentage of the trade of India and Japan. It is cheaper and showy though undurable goods have been flooding Indian Markets. Japan now is also getting very large percentage of the exports from India. The trade with U S A has also considerably expanded. The share of the United Kingdom on the other hand continued to decline. The decline was accentuated as the sentiment factor turned against England during the Great Political movements that marked the last few years. A more even distribution is thus now to be found where formerly there was one-sidedness. The percentage share of the principal countries in India's trade in the pre-war period and recent years is illustrated by the tables appended to Answer to Question No. 1, 1937.

1940

*Question 1.*—What are the functions of money? How does the rupee perform these functions?

*Answer.*—The function of money may be classified as under :—

### (i) Essential Functions

It acts as—

- (a) A medium of Exchange.
- (b) A common measure of value.

Without a medium of exchange mankind would be reduced to the expedient of bartering goods against goods. Money facilitates exchanges by dispensing with that double coincidence of wants and of possessions which barter or exchange without the use of money involved. In simple words it removes the inconvenience of barter and fulfils the functions of a medium of exchange.

It cannot be asserted that the second function of money constitutes a separate and independent function, since it is evident that gold or silver, or any other article can only serve as a value-denominator through being used as the medium of Exchange. By common measure of value is meant that the value of all other goods are measured in terms of it. For example, the value of all other commodities are measured in terms of rupees, annas and pies in India.

### (ii) Derived Functions

(a) *Money serves as a standard of value for deferred payments.*—Most of the transactions in the business world of to-day are transactions that involve deferred payments and it is consequently of the paramount importance that the money promises in terms of which goods and services are parted with should retain the same purchasing power a month or a year hence when the time for fulfilment of these promises arrives. The risk of some undeserved loss and the chance of some unearned profits are in the nature of sales on credit. Whether that risk of loss or chance of gain shall be great or small will depend upon the degree of stability which attaches to the value of article which is used as money. When therefore, payment is to be made at a

future period, the parties to the contract require a medium which will have as far possible the same exchange value in the future as at present

(b) *Money is used for transferring value*—Money helps to transfer value from one place to another or from one time to another. It is possible because money is a good store of value.

(c) *Money stores value*—When it is required to store value it is convenient to hoard money than any other commodity.

Thus we have—

Money's matter of functions four—

A medium, a measure, a standard and Store.

### (iii) Contingent Functions of Money

(1) Money helps the distribution of wealth. Under the present system of production few men produce what they consume. The various factors of production are paid in money with which they buy what they consume. Thus the share of each is given with the help of money.

(2) Money serves as the basis of the credit system. It is kept as a reserve against paper money to meet the occasional demands of the people. But for its prompt convertibility paper money or cheques would not be accepted by the people.

(3) Money has made capital highly mobile by enabling it to adapt itself to the requirements of the time. It has thus made production highly efficient.

(4) Money enables men to make the best use of it by spending their income in a manner which yields the greatest satisfaction. They will regulate their expenses so that marginal utility for every unit of money is the same.

Rupee coin is made of silver and its face value is more than its intrinsic value as metal, therefore, it is a token coin. Nevertheless it is the principal coin in the Indian Currency system. It is unlimited legal tender though not a standard coin. The rupee is the "creature of the state" and its value is fixed by law both for internal as well as external purposes.

*Question 2.*—Explain the position of the Central Bank of a country in the management of the monetary system of the country.

*Answer.*—A Central Bank occupies a very important place in the money market of a country. It holds a country reserve, it is custodian of the cash reserves of other banks, it has the sole right of note issue, it is a repository for the Government balances, in short, it is a great national monetary pool. On the Central Bank of a country devolves the responsibility of managing its monetary system. It exercises control over currency and credit. Its duty does not end with simply issuing metallic coins or paper notes but as a regulatory authority it would shoulder the responsibility equating the supply of currency to the needed demand. Acting as the custodian of the pooled reserves of the nation and expanding the note and deposit liabilities it tends to provide the whole of the extra demand at reasonable money rates.

The Central Bank of a country is thus not only the ultimate provider of cash for the money market when the supply of floating cash in the hands of the Joint Stock Banks and other credit supplying agencies is far smaller than the demand for the same which may be exercised by the Government, the bill-brokers and the Stock Exchange dealers, but it also helps to absorb the excess when such a contingency arises. The performance of this function by the Central Bank has earned for it the well-known term "*shock-absorber*" The unceasing vigilance with which it performs its functions enables the country to escape severe distress resulting from financial crisis, except when these appear as concomitant features of industrial booms or depressions. It is the first function of the Central Bank to maintain stability in the internal value of the currency and prevent fluctuations in the price level through the changes in the value of the money.

On the Central Bank also devolves the responsibility of maintaining the external value of the monetary unit and restricting the outflow of gold. If there is a demand for a foreign currency and the efforts of the bankers and exchange dealers prove ineffective to provide the adequate supply, the Central Bank may intervene and it may itself undertake to meet the demands for remittances by offering for sale exchange on the centre concerned. The Central Bank is in a position to make such offerings because it maintains a reserve of foreign exchange to meet exceptional demands, or because it has standing arrangements for credits in the foreign centre against which it

can sell currency when required. The Central Bank may, as a second alternative, raise its discount rate to influence the exchange in its own favour, for if the raising of the discount rate is effectual, the foreign exchange rate will tend to move in a favourable direction, and the danger of the outflow of gold may be averted.

These measures are regarded as a part of the normal every-day business of a Central Bank, and the success or failure of a monetary system depends on to what extent the Central Bank is able to maintain the internal as well as external value of the currency.

**Question 3**—Prices have risen in India since September 1939. Explain the causes and the consequences of this phenomenon.

**Answer**—The outbreak of war in Europe in September 1939 brought a complete change in the whole aspect of world economy. Wholesale prices rose sharply in September and October in the majority of countries for which figures are available. India could be no exception and upward tendencies in the prices were soon available. There was a general advance in prices in India consequent upon improved foreign demand for India's produce and domestic buying and general optimism prevailed in all markets both as regards the future trend of commodity values as well as the value of off-take. Greater insulation of the home market for indigenous goods and better prospects of industrial expansion in the future were responsible for this buoyant feeling.

\* The wholesale price index advanced from 103 in the end of August (based on 1914) to 135 at the end of 1939. The rise in prices was very marked in the case of jute. Cotton prices soared immediately after the outbreak of war. The rise in prices was not confined to staple articles of export trade. A sharp rise occurred in the wholesale prices of foodstuffs. Rice registered an increase of 20 per cent over the pre-war price. Sugar rose by 30 per cent. Wheat, gram, coffee, groundnuts recorded substantial improvement. An upswing in prices generally and of essential commodities in particular is inevitable while the war continues. The large purchases by the Government of India and the Ministry of Food Supply in the United Kingdom stimulated the upward trend of the price markets in the early months of the war.

Rising commodity prices, increased favourable balance of trade and expansion of currency after the outbreak of war



were the real pointers which raised hopes of substantial recovery in India's trade, commerce and rapid expansion of industries. The Indian cultivator who forms the backbone of the country's economy had gone through considerable suffering in the last decade owing to the continuous fall in prices and lack of foreign demand for India's products. Prices obtained internally and externally were often uneconomic and the position of the average farmer was getting desperate.

The war was expected to bring relief to the Indian cultivator and it appeared for a time that the prospects of improving his position were substantial. But before the full benefit could be derived, measures were introduced by Provincial Governments and legislation was threatened by the Central Government in order to check the rise in prices—a rise which would be only natural in non-belligerent countries.

Any Government measure to control prices of agricultural commodities has no economic justification. The Government sat idle when there was an abnormal fall of prices of agricultural commodities during the years of depression and there seems no reason why it should attempt now to regulate the price level.

The commodity price outlook is one of the main uncertainties that war holds out for business. Rising prices indicate, to a certain degree, the extent of national prosperity but, their influence on trade, industry and social welfare requires careful attention. A study of the effects of high prices on the principal industries show that high prices are not an unmixed blessing.

Except Jute, the demand for the other commodities is not largely and directly affected by the war. The higher prices of industrial raw materials caused grave concern to Indian trade and industry in general. For example, the Indian cotton textile industry was much handicapped by the fluctuations in the prices of raw cotton. In the earlier months of the war cotton prices, in sympathy with prices of other commodities, moved upward and appreciated out of all proportion to the current prices for textiles. The result was that the indigenous cotton industry was obliged to bear a strain during the period of adjustment of Indian cotton prices to world parity. The manufacturers in order to keep down costs were obliged to give up the production of superior grades of textiles. The industry must, however, be benefitted in another direction.

The benefits of higher prices for agricultural prices accrue to the rural population and, therefore, the increased purchasing power of the masses should result in an increased demand not only for Indian textiles but also other industrial goods produced in the country. But before these hopes could realise the cotton industry as well as other industries came to be faced with a demand from labour for increased wages. As a result of the higher prices for staple foodstuffs, the working class cost of living indices in the principal urban and industrial centres have risen considerably since the outbreak of the war and resulted in a clamour of labour for dearness allowance, payment of dearness allowances has affected the entire range of industries in this country which depended upon national demand.

*Question 4.*—Discuss the place of the Stock Exchange in the money market of a country. Illustrate your answer from Indian conditions.

*Answer*—The Stock Exchange is an important constituent of the money market. It is a market where the invested capital in the form of stocks and shares is bought and sold on the basis, not of their original value, but of their actual value determined by present and prospective earnings. The Stock Exchange is not a market for new capital but is the market for capital already invested. A good Stock Exchange market is indispensable in the present times. Without a ready market persons holding shares in industrial concerns and other enterprises would not be able to turn locked up capital into readily available purchasing power. It is the Stock Exchange where an unsaleable individual part ownership (a ten thousandth share in a railway perhaps) is transformed into a stock or bond having a wide market. So readily can it be sold that it is almost money itself and being pledged it obtains an immediate supply. The Stock Exchange mobilises the wealth of a nation, enables capital to be found for large undertakings, and offers safe and profitable means of investment. A Stock Exchange facilitates the transfer not of capital from one industry to another but of shares of existing business from one owner to another. Indirectly it is the means of guiding new capital into the industries in which it is most needed.

So important position the Stock Exchange now occupies in the money market that it has been described as the nerve centre of the politics and finances of nations and as the barometer of their prosperity and adversity. The political and

financial changes with regard to the Government of a country are immediately focussed and find instantaneous expression in the Stock Markets. A mere glance of the tone of this market would indicate the credit of a nation or the position of an industry.

In fact, these stock exchanges should be regarded as necessary concomitants of industrial development. They play a very important part in directing the flow of capital to industrial enterprise, and supplying long term credit without which many industries would not at all come into existence.

The Stock Exchanges in India are not so developed as the Stock Exchanges in London or New York.

Industrial and commercial development is to a great extent essential for the growth of share business and until recent years India had been very backward in such development. Side by side with the growth of limited companies and the establishment of various industrial enterprises in the country, the Stock Exchange business has grown from strength to strength, but it has not as yet established itself as a great financial organisation as in other countries. Stock Exchanges have been established in Bombay, Madras and Calcutta but the business transacted in these markets is limited. Stock Exchanges cannot be established in other centres unless enough business is forthcoming. The conditions in other industrial centres are not such as to make it possible to have stock exchanges. The Stock Exchanges in India, though a constituent member of the money market cannot be said to perform the same functions which a similar institution performs in countries like England and U S A. Indian capital is shy and the industries have as yet no attraction for it. Banks also hesitate to enter into big commitments with the stock brokers.

*Question 5.*—Discuss the position of the Reserve Bank of India in the Indian money market. Can you suggest improvements?

*Answer.*—Prior to the establishment of the Reserve Bank of India in 1935, India had a dual system of control over her credit and currency. The Government controlled the currency and the credit situation, so far as it was controlled at all, was controlled by the Imperial Bank. Divided control meant divided counsel and failure to co-ordinate. With the inauguration of the Reserve Bank the control of

both credit and currency was placed in the hands of a single authority

The Reserve Bank has been working for some years but has not unfortunately come upto the expectations. The Bank has failed to assist the other banks in case of emergency. The failure of the Quilon Bank due to the Reserve Bank's refusal to help it, sheds considerable light to help the other Indian Banks (which form an important constituent of the money market) in trouble. The Bank has also neglected the duty of co-ordinating the indigenous banking system to the modern banking system. It has also not been able to control credit. Its Bank Rate does not have much influence in the money market and is as unimportant and ineffective as was Bank Rate of the Imperial Bank. To know the causes of the Bank's failure in its complete control of the money market, it is necessary to go farther and find out what are the weapons in the hands of a Central Bank to exercise control and how far they have been used by the Reserve Bank and with what results.

The chief instruments of credit control at the disposal of the Central Bank in a country are (1) credit rationing, (2) moral suasion, (3) the discount rate, and (4) open market operations. So far as the first weapon is concerned it is out of the question in India for the Reserve Bank has not yet attained such a position of strength and respectability that in rationing credit it may expect to escape from the charge of favouritism. By moral suasion is meant the advice given or request made by the Central Bank to the market. The effectiveness of this policy depends upon the willingness of the market to co-operate with the Bank. It is idle to expect any useful result for this particular policy in India until the Reserve Bank of India attains the position of the Bank of England or the Bank of France.

Discount rate is regarded to be the most powerful instrument of central banking control but unfortunately in India, it is ineffective for all practical purposes. This is due to the fact that the bank rate does not permeate the entire banking system. The money market in India is divided into two parts, the European and the indigenous. There was no cohesion between these parts of the market and there were frequent differences between the bank rate and the bazar rates. The Reserve Bank has tried to supply the central co-ordinating agency but matters have not improved. The Reserve Bank is still unable to control the money market.

satisfactorily by raising or lowering its bank rate, for the operation does not bring a corresponding rise or fall in the market rate. Indigenous banking is not materially affected by the Reserve Bank rate. Even the Commercial Banks do not respect the Bank rate. Most of the Joint Stock Banks have their overdraft arrangements with the Imperial Bank and it is, therefore, the Imperial Bank advance rate which is of primary concern to them. While at present the Reserve Bank rate stands at 3 per cent the Imperial Bank rate was raised to  $3\frac{1}{2}$  per cent and most of the Joint Stock Banks raised their discount rates when the Imperial Bank rate was altered.

The fourth method of Central Bank Control, the open market policy, is employed in order to make effective a given Bank rate policy or it may be employed by itself when changes in Bank rate are considered undesirable. But even here it is doubtful if the Indian Money Market is sufficiently wide to enable the Reserve Bank to resort to this method.

We may now consider the obstacles in the way of the Reserve Bank to have an effective control over the money market. The existence of indigenous bankers outside the organised system is found to be the most serious one. If one remembers that 90 per cent of Indian banking is in the hands of these bankers one can form an idea of the predominating influence exercised by them over the Indian Money Market as a whole. Hence the first step which the Reserve Bank should take is to link indigenous banking with the organised banking system. Unless this is done the Reserve Bank cannot unify the two main parts of the Indian money market.

The power of the Central Bank in relation to the money market depends firstly, on how far the money market is accustomed to depend on its own funds and on funds borrowed from banks and secondly, how far banks themselves have occasion to apply for rediscounts or loans from the Central Bank.

The volume of bills arising in India is not very large and shows small prospect of any material growth. The second step, therefore, lies in the establishment of an open bill market in which first class bills are freely negotiated. In the absence of a proper bill market rediscounting facilities must be inadequate. If such a market could be developed it would be possible for the Reserve Bank to extend its open market operations to trade bills in addition to Government securities in order to have a control over the money market.

Moreover, by its Bank rate it will be able to control effectively the other interest rates in the money market.

With the increasing use of commercial bills and the development of an active discount market, with the willing co-operation of the scheduled banks, with the Reserve Bank operating fully as a bankers' bank and not as a rival institution, with the indigenous bankers brought within the fold of organised banking, it will be difficult for the Reserve Bank to achieve a unified control of currency and credit.

*Question 6.*—Why do nations trade with one another? Illustrate your answer.

*Answer*—Every country engages itself in the production of those commodities for which it is best suited and in the production of which it possesses most relative advantage. It will engage in an industry in which it can get the maximum profit by employing certain amount of labour and capital and will depend on other countries for the supply of those commodities for the production of which another country possesses better opportunities. England prefers to produce woollen goods and depends on Denmark for its cheese and butter though her own pasture lands could enable her to maintain a good and successful dairy industry. The reason is that England though possessing an advantage over Denmark in the production of dairy products, possesses greater advantages in the production of woollen goods and so she will devote herself in the production of those goods in which its superiority is greatest and exchange these goods for other imports like butter and cheese, in which its superiority though real is not so great. No single country can have the resources and potentialities for the production of all its requirements and every country has, therefore, to depend upon others to supply it with those materials which it cannot itself produce or can produce at a relative disadvantage, in exchange for the commodities which it can produce profitably. This is the law of comparative costs and is at the basis of international trade. It explains why different nations trade with one another and are able to enjoy a variety of products at a comparatively cheap rates by such mutual exchange.

*Question 7.*—Discuss the effects of the Protection of Indian industries on the foreign trade of India.

*Answer*—The probable effect on the foreign trade of India is not a subject on which it is safe to express any

opinion The immediate effect would naturally be to diminish imports, decrease demand following an increased cost. The imposition of a prohibitive tax on a foreign article will check the import of that article except at an increased cost and this rise in the price will lead to a fall in the demand for that article. There will also be factors tending to a diminution of exports. Any general rise in prices in India must discourage exports by making their cost to the foreign purchaser dearer and apart from any rise in internal prices a reduction of imports will tend to raise exchange and thus to diminish exports. Again protection will lead to an increased local consumption of raw materials previously exported. This will lead to a fall in the exports of the country. But on the other hand there is the possibility that the development of Indian Industries will produce an increased export of manufactured articles. On the whole from a consideration of these various tendencies it may be concluded that the immediate effect of protection will be some diminution both in imports and exports but it is impossible to predict whether there would be any change in the balance of trade.

*Question 8* — Discuss the organization and progress of the steel industry in India, and explain the importance of this industry in the industrial development of India.

*Answer.*—The iron and steel industry is of profound importance in the economy of a country. It provides machinery which is the life blood of industrialism, and economic progress. This is the reason why it is called the key industry.

### **Prospects of the Industry.**

India is endowed with the requisites of iron and steel industry. The most important condition of the development of the iron and steel industry is the presence, in adequate volume, of deposits of rich iron ore and coking coal, situated sufficiently near to each other to reduce the cost of transport of raw materials. The researches of the geological survey have established that these natural advantages are very great, indeed, especially in the matter of the quality, quantity and cheapness of the iron ore. As regards coking coal, the superiority is no doubt less marked but as Sir E Pasco the eminent Geologist says: "There is enough coking coal in India to supply the iron and steel industry with 4,000,000 tons with metallurgical coke per

annum for the next 150 years. Another great advantage consists in the nearness of the coal fields and the iron ore deposits. India has also adequate supplies of limestone and manganese ore. From the point of view of the raw materials, we find that the country is favourably placed. As regards labour India has vast population which can supply labour, enough to sustain as large a productive activity as that of the foremost industrial nation to-day. The question which now remains for consideration is that of market. India has been such a large importer of iron and steel that a ready market may be said to exist in the palm of our hand.

Thus, India possesses all the advantages for the development of iron and steel industry. The principal Centre for the manufacture of steel in India is Jamshedpur which is well situated for being the centre of steel making in northern India. The deposits of iron ore are only 50 miles away and coal has to be brought from a distance of 100 miles while within the same radius limestone and dolomite are found. The cost of transportation is not much, unskilled labour is found in abundance at comparatively low wages from the Bilaspur and Chattisgarh districts of the C P and from Chota Nagpur and Orissa as Jamshedpur is on the main line to Nagpur and is connected with Orissa and Chota Nagpur. The Sabarnarekha river supplies the water requirements of the industry though it has no utility from the point of view of transportation. But one great factor which has enabled the industry to make rapid strides is that the necessary capital has been forthcoming.

### Progress of the Industry

It was during the 19th Century, when the demand for iron and steel goods began to outstrip their supply in Europe, that attempts were made to introduce the blast furnace for smelting iron with charcoal as fuel. All such attempts failed without exception. The history of the modern iron and steel industry in the country really began from the closing years of the preceding century when the Bengal Steel and Iron Company was started. This company had a chequered history but did fairly well particularly during the Great War. Shortly afterwards was started the Indian Iron and Steel Company which was equipped with most up-to-date machinery, and threatened to wipe off the map all its competitors. The situation was saved by the old company by acquiring a majority shares of the new venture. The most important event in the history of the industry was



the inception of the Tata Iron Company which began to produce pig iron in 1911 and steel for the first time in modern days in India in 1913.

The first Great War gave a great stimulus to the Indian steel industry by providing it with a sort of protection. Many kinds of manufactures which would have never been undertaken for a long time but for such a stimulus, were taken in hand. Vast extensions were completed in 1924. In the same year, as a result of an inquiry conducted by the Indian Tariff Board, protection against foreign competition was granted to the steel and iron industry. It was renewed in 1933-34. Under this regime the industry has made remarkable progress. India is now self-sufficient as regards her requirements for pig iron of which the production has advanced from 35,000 tons at the beginning of the present century to 1,343,075 tons in 1934-35 and 1,540,000 tons in 1935-36.

In 1934-35 the Government of India on the recommendation of the Tariff Board imposed as a revenue measure an excise duty on steel produced in British India. Counter-vailing custom duties corresponding to this excise duty were imposed on imported iron and steel articles. As was to be expected imports of iron and steel goods into India increased from 370,100 tons in 1935-36 to 490,500 tons. Imports of iron and steel goods also rose from 222,300 tons to 280,500 tons.

### **World War II and Steel Industry.**

During the World War II not only was the production of steel controlled by the Government, but to conserve dollar exchange even imports were not allowed free. A Steel Controller was appointed and made responsible for collecting and placing orders through the British Purchasing Mission on behalf of Government Departments and Railways and of those private firms which wished to benefit by the contracts placed with the American industry by the British Ministry of Supply. The effects of all these controls was the stringency in the Indian market. Prices of finished steel soared up to dizzy heights in the black market. The fact is that even up to this date steel is not available without influence or pressure. There is a considerable pent up demand which can be met effectively only when at least the more works of Tata capacity are established in the country.

According to some leaders of industry the World War II did not give any impetus to the iron and steel industry. On the contrary, it held up even normal extensions and expansions which would otherwise have taken place. Production has fallen down. Labour troubles, communal disturbances and coal shortages have been responsible for the decline in production.

One important feature of the steel industry in India is the integration of all the processes of manufacture under the same firm. The Tata Iron & Steel Co., owns Iron mines, Coal mines, Coke ovens, blast furnaces, limestone quarries while it has its Bar Mills, Rail Mills, Sheet Mills as well as the By-product plant for the manufacture of Ammonium Sulphate. The same tendency is noticeable in the other centre of Iron industry, in the area around Asansole where are congregated the Indian Iron & Steel Co., at Burnpore, the Bengal Iron & Steel Co., at Kulti and the Kirtyananda Iron Factory at Sitarampur.

Bengal Iron & Steel Co. was the first in the new field of India's industrial development and began its operations as early as 1889. It owns its iron mines in the Kolhan Estate, Singhbhum and in Ghatsila in Dhalbhum, while its coal mines at Ramnagar are only two miles off from the works. Thus at this centre the iron ore is brought from a distance to the colliery. The Indian Iron & Steel Co. at Burnpore receives its ore from its mines at Gua in Singhbhum and limestone from its quarries at Guttanagar. This Company specialises in the production of pig iron although the waste products are utilised by it in the manufacture of coal tar product, Sulphate of Ammonia and Sulphuric Acid. The railway communication of the factories of both the companies with their respective Iron Mines is quite adequate and is supplemented by rope ways which connect the mines with the railhead.

The localisation of steel industry at Jamshedpur has been responsible for the growth and development of a large number of subsidiary industries round about the place which use partly finished steel for their manufactures. These subsidiary industries get all the advantages of geographical situation as the main industry and in addition to it get the raw material close at hand. Among the industries which have sprung up at Jamshedpur the most important is the Tinplate Industry which manufactures tins for the transport of kerosene and petrol, for packing cigarettes and biscuits. Another industry is the Indian Steel & Wire Products Ltd, which

manufactures barbed wire and galvanized wire as well as ordinary wire and wire nails. This company depends upon Tata Company for its raw material and purchases from them its requirements of steel rod. The Agricultural Implements company of Jamshedpur manufactures picks, spades and hoes while the Peninsular Locomotives Company was started at Jamshedpur for the manufacture of locomotives. Both these industries depend upon Tata Steel for their raw material.

During the war years the iron and steel industry has very considerably expanded in Canada and Australia. India is on threshold of an industrial revolution, but no progress, worth the name in agriculture, industries, communication or transport can be possible without the development of this basic industry on which hinges our whole industrial future.

*A few figures.*—The block capital invested by the Tatas, Mysore Steel Works and Steel Corporation of Bengal in plants is over 53 crores.

The plant and equipment used in the steel industry in India are mostly of foreign manufacture and the industry has to continue to depend on imported machinery for the present.

Where only a quarter of a century ago the industry had to depend on foreign technicians, during the last few years labour and skilled personnel employed in the industry has been mostly Indian. This has been possible owing to the foresight of the management in training suitable Indian youths for the steel industry.

*Question 9.*—Write short notes on:—

- (1) Balance of payments.
- (2) Cartels.
- (3) Devaluation.

*Answer.—Balance of Payments.*—The term “balance of payments” or “balance of accounts” generally indicates the relation between imports and exports of commodities. Imports and exports are rarely equal (i.e., balanced) in actual trade between nations. Therefore in considering the balance of payments, we have to consider not only the balance of trade resulting from the export and import of commodities but all the items of credits (claims) and debits (debts) of the country called invisible exports and imports which also create obligations and claims. The following are some of the main items:—

(1) freight and insurance charges, (2) interest on capital invested abroad, (3) expenses of foreigners living abroad, (4) Banker's commission, (5) Government expenditure in foreign countries, (6) payment of war debts and reparations, (7) loans taken or lent by a country.

(2) *Cartels*.—This is a looser form of organisation than the trust. The combining units retain their original independence, unlike the trust, and act together only on certain specific points *viz*, uniform price and regulation of output. Thus unlike Trusts, they do not directly control the entire management of the combining units but only a certain part of it. Cartel does not control the profits of these units but only their output and selling price. The Cartel is a temporary organisation and the combining units may secede from it when they find it going against their interest. The Cartel system of organisations is common in Germany.

(3) *Devaluation* — It is the process by which the currency unit of a country is lowered in value by reducing its gold content to that extent necessary to make the mint parities with gold standard countries equal to the existing rates of exchange. When the value of the monetary unit of a country has depreciated and the restoration of the value to its pre-level is an impossible task the Government may stabilize the currency at the new level by reducing the gold content of the coin in terms of other gold using countries. This is what in strict sense of the word is called devaluation. But lowering of the external value of a coin may be achieved by fixing the exchange rate in terms of the currency unit of another country at a lower rate. Thus, for example, the process of devaluation in case of the Indian rupee may be complete by lowering the rupee-sterling to say 1s 4d.

## 1941

*Question 1*—Explain the significance of the fact that the pound sterling has been an inconvertible paper currency unit since 1931.

*Answer*—The bank of England was under the Gold Standard Act of 1925 "bound to sell to any persons" gold bullion at £3, 17s. 10½d. per ounce of "standard" gold but only in the form of bars containing a minimum of 400 ounces (troy) or pure gold. This meant, of course, that the Bank was, compelled to cash its notes provided that the total presented was not less than the equivalent of 400 ounces of Gold at £3, 17s. 10½d. per ounce. When Great Britain renounced the gold standard in 1931 the section of the Act of 1925 relating to the selling of gold by the Bank was suspended and as a result the Bank of England is no longer bound to give gold for any of its notes, not even if the value of those presented is equivalent to the value of 400 ounces of fine (i.e., pure) gold. The notes, however, circulate freely as currency in the country. This is what is meant by saying that the pound sterling has been an inconvertible paper currency unit since 1931.

*Question 2.*—Discuss the causes and nature of a trade cycle, and examine its effects. Give illustrations.

*Answer.*—See {answer to Question No 1, Economics, 1937.

The many units in the productive industry are so closely related that depression in one tends always to produce depression in others. The workers in one large department of industry are consumers of the products of their fellow workers engaged in other branches. Consequently, a period of distress in one section of a community tends to spread and eventually to embrace the greater part of the productive machine. Employers in one trade are made apprehensive by the failure of employers, in another, and, in order to safeguard themselves, may restrict their operations, thus similarly affecting other producers from whom they obtain supplies of raw material. Many labourers are thrown out of employment and as there is a fall in the purchasing power of many communities, several trades are affected at one and the same time.

*Question 3* —What is the currency standard of India at present and how is it maintained ?

*Answer* —The currency standard of India at present may be called the Sterling Exchange Standard. The Indian currency unit, the rupee, has a value fixed in terms of sterling. It is  $\frac{3}{40}$ th of the sterling or equal to 1s 6d. As the value of the rupee is maintained in terms of its exchange with the currency of another country, namely, sterling, the standard is called the Sterling Exchange Standard.

This is not accepted as the final verdict on the question of a suitable monetary standard for India. The whole question of the monetary standard best suited to India will have to be reviewed when the international situation has become sufficiently stable.

"The Reserve Bank is required to maintain the 1s 6d. sterling ratio between fixed upper and lower points as though the rupee was on a gold basis. The bank is required to sell sterling to any person who makes a demand in that behalf at its office in Bombay, Calcutta, Delhi, Madras, Rangoon and pays the purchase price in legal tender currency, for immediate delivery in London, at a rate not below 1s  $5\frac{1}{8}$ d for a rupee. This provision is intended to prevent the rupee from falling below 1s  $5\frac{1}{8}$ d which corresponds to the lower point of the rupee (i.e., 1s 6d minus the cost of laying down in London this amount of sterling). On the other hand, it is necessary for the bank to buy sterling from any person who makes a demand in that behalf at its office in Bombay, Calcutta, Delhi, Madras or Rangoon, for immediate delivery in London, at a rate not higher than 1s  $6\frac{3}{8}$ d. for a rupee which corresponds to the upper point of the rupee (viz 1s 6d plus the cost of importing this amount of sterling from London to Bombay). It has also been laid down that no person shall be entitled to demand to buy or sell an amount of sterling less than ten thousand pounds."

"The Reserve Bank Act thus legalised the existing ratio and provisionally established in India a sterling exchange standard of improved type, in so far as there is a definite statutory parity prescribed for the rupee and an obligation under law imposed upon the Reserve Bank to maintain the rupee at this parity."

The sale of sterling has the effect of contracting the supply of internal currency. This in accordance with the

Quantity Theory of money has the effect of increasing the value of the rupee or at any rate preventing it from falling below its parity. The purchase of sterling by the people results in an expansion of currency. This in accordance with the Quantity Theory of money lowers the value of the rupee and thus prevents the rate of exchange from rising above the fixed parity.

*Question 4.*—Why is the Central Bank in a dominating position in a modern money market? How far does your answer apply to the Reserve Bank of India?

*Answer*—See answer to Questions Nos 2 and 5, *Economics*, 1940.

*Question 5.*—Define "Speculation". What are the advantages and disadvantages of speculation in industrial securities?

*Answer*—The word speculation in the economic sense is used first to mean 'the legitimate risk run by the entrepreneur or business organiser in the conduct of his business. The word is also extended by some to include the operations of a skilled person who, while not being a manufacturer, merchant or necessarily a buyer from producer or a seller to a consumer, undertakes to buy and sell quantities of a commodity in the expectation of making profit out of his estimate of its future rise or fall in price

Stock exchange speculators buy stocks and shares merely to sell again in the same place and at almost the same time, they are not investors in the true sense that they hold stock for the sake of the interest which they may thereby receive upon their capital. They may make a buying price and afterwards (or it may be before) a selling price and seek profit from the difference between the two; they are only interested in the interest or dividend to the extent that any variation or prospective variation in its amount relatively to the general or average rate causes a change in the capital value

Speculators may perform desirable services for the community in steadying prices, in equalising consumption and in reducing waste. These services are chiefly performed in connection with commodities produced irregularly because of seasonal changes. Speculation on the stock market does not have quite the same effect in levelling prices. It may, indeed, induce fluctuation. The stock exchange

exists to facilitate, not the starting of new companies, but the buying and selling of shares in established companies and what service to society is performed by the man who buys shares at one time and sells them at a higher price a little later it is difficult to see. Dealing with shares has no influence in adjusting supply to demand because the supply of share of any company is a fixed amount and not an irregular flow.

Speculation, by substituting the payment of differences for the payment of the full prices of the commodity or the shares dealt in, provide an encouragement to outsiders to come in and gamble and tempts persons with small capitals to undertake operation that require for safety a larger capital than they possess. It gives in fact an encouragement to gambling. Gambling causes runs of many and thus discourages genuine investors to invest capitals in shares of similar industries. The speculation mania has often reached such heights that a serious shock to public credit has been very narrowly escaped. The bull and bears in stock exchange markets remain very active, and their recriminations do not present an edifying spectacle to the outside public and sometimes it becomes necessary to end their wranglings by legislation. Illegitimate speculation in industrial shares is as harmful to the industries as is such speculation in commodity market, speculators very often adopt similar tactics as in the commodity market to raise the prices of industrial shares. Attempts are made to 'rig' the market by disseminating misleading information and causing, as the case may be, nervous holders to sell or eager buyers to purchase quickly thus starting a movement of prices in the desired direction and of which the operators take advantage. Rumours are spread deliberately that a company has discovered new markets for its goods, that it is going to pay higher and higher dividends, and a show is made of buying its shares when there is no intention of holding the shares for long. The public is misled and begins to buy the shares thus raising their price. The suitable moment, for unloading, having arrived, the manipulators sell out at inflated prices. The inevitable fall in price inflicts heavy losses on the gullible public.

This form of speculation is harmful to the community generally, inasmuch as private investors are frequently victimised and violent fluctuations in prices are engendered. A stock-exchange crash may be followed by a severe depression. The world crisis of 1929 was preceded by a stock-exchange crash.



in the United States which ruined hundreds of American speculators. Before the crisis business profits in the United States were increasing, though commodity prices had not risen markedly. Profits increased considerably because improvements in methods of production and management had brought down costs. The very high profits earned in the automobile industry, for example, led to over-investment in that field, and the capacity of the industry reached the most amazing proportions.

With the growth of industrial profits speculation grew and prices of industrial stocks leapt up. Kemmerrer thus describes the situation:

"Prices of stocks on our exchanges rose to figures out of all proportion to the earnings, actual or prospective, of the respective companies. From September, 1924 to September 1929 the mean of the monthly high and low daily averages of prices of 351 industrial stocks, as given by the Standard Statistics Company, rose from 70.7 to 216, and for 33 railroad stocks from 79.3 to 168 1. The volume of monthly sales on the New York stock-exchange increased during the same period from 18 million shares to 100 million shares."

Much of this activity was purely speculative, and the speculative boom in shares was followed by the inevitable crash. Very often speculators speculate with money borrowed from the banks. So long as credit was easy, loans could be obtained cheaply. When bankers, growing nervous, stiffened their rates and restricted credit, the boom suddenly ended and prices of stocks and shares fell as sensationally as they had risen.

**Question 6.**—What are the principal effects of the present War on the external trade of India?

Give a brief account of the commercial agreements made by India with other countries in recent years and examine their effects.

**Answer**—Since the beginning of the war in September 1939, Indian exports had shown a marked tendency to increase and this movement was accelerated during 1940. The total value of India's exports aggregated Rs. 238 74 crores as compared with Rs. 189.30 in 1939, showing an increase of Rs. 19 44 crores whereas imports were almost static at Rs. 162 95 crores as against Rs. 161.03 crores in the previous year. The favourable

merchandise balance of trade, in consequence, increased considerably from Rs. 28 28 crores last year to Rs. 45 79 crores in 1940. Figures in connection with export of gold, which has been an important feature of Indian trade for the last ten years, are not available, but taking into consideration the total amount of sterling purchased by the authorities aggregating £70½ million or Rs 94 crores, and comparing this with the merchandise balance of trade, aggregating Rs 45 79 crores, the figure of export of gold would seem to be considerable during the current year, although it must not be forgotten that quite large payments have been made in sterling by the British Government, from time to time, to the Government of India for purchases of war supplies in this country. The rise in exports is largely contributed by the items of jute and cotton manufactures. The former accounted for an increase of Rs 16 crores and the latter for Rs 6 crores over the previous year. Total exports of jute manufactures amounted to Rs 54 64 crores and of cotton yarn and manufactures to Rs 14 17 crores as compared with Rs 38 43 crores and Rs 7 94 crores respectively in 1939. Although the quantum figures of export trade, are not available, judged by the index number of wholesale prices in Bombay which declined to 112 in August and stood at 118 in December, 1940 as compared with 128 at the beginning of the year and 135 in December, 1939, it would appear that exports had also increased in quantitative terms. The increase in exports, therefore, is not from any rise in the price of India's staple products.

Although the total imports showed very little variation from last year there was a remarkable fall in the item of grain, pulse and flour imported, which declined from Rs 22 crores in 1939 to Rs 16 50 crores in 1940. Imports of cotton yarn and manufactures also showed a fall of Rs 2 crores over the previous year. There was an almost corresponding increase in the country's imports of oils, which advanced from Rs 17 47 crores to 21 05 crores in 1940 and of raw cotton, which rose from Rs 7 65 crores to Rs 9 40 crores.

Analysing the import and export trade by countries we find that there have been many changes in the directions of trade. The table on the opposite page which gives Indian exports and imports (for the calendar years) grouped according to countries reveals that whereas on the export side the largest increase has been in the case of the United Kingdom and the British Empire, the volume of imports from the Empire countries has not materially altered. In the case of Japan, exports have declined and imports have increased sharply, while the United States of America purchased more

of our goods and sold more to us, although the rise in imports from the U. S. was much greater than the increase in our exports to that country

### TRADE OF INDIA.

Countries.	Exports.		Imports.				Balance.	
	1939 (1)	1940 (2)	% change of (2) over (1)	1939 (3)	1940 (4)	% change of (4) over (3)	1939	1940
Total	180,32	208,74	+15,76	161,03	162,95	+1,19	+19,29	+45,79
United Kingdom	57,36	78,42	+36,71	40,61	41,16	+1,35	+16,75	+37,28
British Empire exclu- ding U. K.	36,43	49,37	+35,52	51,47	52,51	+20,20	-15,04	-3,14
Germany	4,01	Nil	-100,00	10,42	12	-99,04	-6,41	-12
Netherlands	2,74	64	-76,64	1,39	91	-34,53	+1,35	-27
Belgium	3,19	1,12	-64,89	2,41	1,82	-24,48	+78	-70
France	6,20	7,95	+28,22	1,49	1,01	-32,21	+4,71	+6,94
Italy	1,79	1,28	-28,49	1,99	1,09	-45,22	-20	+19
Japan	13,53	11,10	-17,96	17,91	20,83	+16,30	-4,38	-9,73
U. S. A.	20,94	26,67	+27,36	11,78	24,58	+108,66	+9,16	+2,09
Others	34,13	32,19	-5,63	21,56	18,92	-12,24	+12,57	+13,27

No information about the items which constitute the trade between India and other individual countries is available, but it can perhaps be said that the expansion in India's exports to the United Kingdom is mainly the result of increased absorption by the latter country of Indian foodstuffs, industrial raw materials, jute and woollen manufactures and leather goods. Other countries of the Empire have shown greater interest in Indian cotton manufactures and have taken larger quantities of raw materials for their expanding industrial production. The U S has absorbed larger quantities of raw materials which are of a strategic nature and in spite of the increased use of substitutes, raw jute and jute manufacture still form an important portion of India's export to the U. S.

The increase of over 100 per cent in India's imports from the U S was mainly the result of increased purchases of American manufactures, machine tools and chemicals. According to the U S trade figures her exports to India of finished manufactures increased from 29,857,000 dollars in the first eleven months of 1939 to 39,619,000 dollars in the corresponding months of 1940. During the same period exports of semi-manufactures increased from 3,414,000 dollars to 15,755,000 dollars and crude materials from 2,030,000 dollars to 5,695,000 dollars.

In spite of Japan's exit from the sterling block and the linking of the yen to the U S dollar, which resulted in the appreciation of the Japanese currency in relation to the rupee with the depreciation of sterling against gold currencies, India's imports from Japan increased by about 17 per cent during 1940 and exports decreased by 18 per cent. While the decrease in imports from India was to some extent due to Japan having found alternative sources of supply in East Asia and Latin America, the increase in Japan's exports to this country partly represented Indian purchases of Japanese manufactures to replace European supplies which are no more available. For example, artificial silk yarn which we formerly imported from Italy is now largely supplied by Japan.

**Question 7** — Explain the principles of the policy of Discriminating Protection. What changes would you advocate in this policy?

The policy which resulted from the report of the Indian Fiscal Commission is what is known as Discriminating

Protection. Under this policy not all industries are eligible for Protection but only industries which fulfil certain necessary conditions. These conditions as stated in the Majority report of the Fiscal Commission are as follows :—

(1) The industry must be one possessing natural advantages such as abundant supply of raw material, cheap power, a sufficient supply of labour or a large home market. Such advantages will be of different relative importance in different industries but they should all be weighed and their relative importance assessed. The successful industries of the world possess certain comparative advantages to which they owe their success. No industry which does not possess some comparative advantages will be able to compete with them on equal terms and, therefore, the natural advantages possessed by Indian industry should be analysed carefully in order to ensure as far as possible that no industry is protected which will become a permanent burden on the community.

(2) The industry must be one which without the help of protection either is not likely to develop at all or is not likely to develop so rapidly as is desirable in the interests of the country. This is an obvious corollary from the principles which have led us to recommend Protection. The main object of Protection is either to develop industries which otherwise would not be developed or to develop them with greater rapidity.

(3) The industry must be one which will eventually be able to face world competition without Protection. In forming an estimate of the potentialities of this condition being fulfilled, the natural advantages referred to in the condition (1) will, of course, be considered carefully. The importance of this condition is obvious. The Protection we contemplate is a temporary Protection to be given to industries which will eventually be able to stand alone.

The conditions laid down by the Fiscal Commission closely follow the line of thought by which the protection of an infant industry was recognised by the older economists as a legitimate exception to the doctrine of Free Trade. Protection, that is to say, is to be granted only to such industries as have a reasonable chance of establishing themselves in the country and only as a temporary measure to enable them to surmount the period of initial struggle. Although the conditions formulated by the Fiscal Commission are generally

unexceptionable [in theory, [the way in which Protection has been administered with reference to these conditions has been the subject of considerable criticism.

The first condition is that the industry concerned should possess natural advantages such as a local supply of raw materials, adequate market, etc. The factors mentioned in this condition are illustrative of the kind of natural advantages which an industry applying for Protection should possess. It was not intended by the Fiscal Commission that any one of these factors or all of them should be necessarily present, but that, on a general review of the position of the industry, it should be established that the balance of advantage is in favour of the industry. In recent years the Government of India have placed a more rigid interpretation on this condition and have insisted that the principal raw materials required for the industry should be available in India before Protection can be granted. The application of the glass industry was refused on the ground that soda ash was not available in India, although in the opinion of the Tariff Board, on a review of all the circumstances, the industry possessed sufficient advantages to compensate it for the absence of soda ash. In the earlier years the Government of India had adopted a more liberal interpretation of this condition. For instance, the match industry was declared protected although an essential raw material, wood of quality suitable for the manufacture of splints, was not, in the opinion of the Tariff Board, available in commercial quantities in India. The interpretation placed in recent years is neither fair to Indian interests nor justified by economic considerations. The cotton textile industry has established itself as one of the most important industries in England and Japan. In neither case is the principal raw material, raw cotton, present in the country of manufacture. The rubber goods industry is one of great importance in the U S A, but America does not produce natural rubber.

The second condition is that the industry cannot develop unless Protection is given. This is really a truism and can hardly be called a condition because if the industry is in a position with reasonable economies to carry on without Protection, the effect will necessarily be reflected in the estimate of the degree of Protection required by the industry. If the industry can stand competition unaided, the margin between the import price and the fair-selling price which, according to the practice of the Tariff Board, measures the amount of Protection required, will reach vanishing-point.

The third condition requires that the industry will be able eventually to dispense with Protection. This is really the effective condition of Discriminating Protection because if this condition is satisfied, it necessarily implies that the first condition is also satisfied. It is obvious that unless there is a balance of advantage in favour of an industry, it cannot establish itself eventually. In actual practice it is most difficult to express an opinion of even approximate accuracy regarding the applicability of this condition. It is practically impossible even for the best-informed and most competent Tariff Board to forecast the position of an industry over a period of years so as to judge with sufficient precision whether it will eventually require assistance or not. The economies in costs of production and the level of import prices which may eventuate during a specified period depend on so many uncertain factors that no Tariff Board can be expected to pronounce a reasonably valid judgment on the extent to which an industry fulfils this condition. In the whole course of the Tariff Board's existence there has been only one case in which the Board has declined to grant Protection to an industry on the ground that it will not be able to dispense with Protection eventually. This is the magnesium chloride industry. The Tariff Board declined to grant Protection to the industry in 1924 on this ground. The Government accepted the Tariff Board's conclusion. Three years later, in pursuance of the Government's policy of reducing or abolishing the duties as required by the cotton textile industry, even the revenue duty on magnesium chloride was removed. In 1928 the industry came up again for Protection and in this inquiry it was found by the Board, on a review of costs and prices, that the industry would not merely be able to dispense with Protection ultimately, but that it did not require any greater assistance than the restoration of the original revenue duty. The case of the magnesium chloride industry provides an interesting illustration of the practical difficulties involved in the application of the crucial condition on which Discriminating Protection is based.

In spite of these criticisms of the policy of Discriminating Protection, it is necessary if we are to form a fair and correct judgment regarding its working, to recognise the substantial successes achieved by it. The progress made by industries which have received Protection is illustrated by the following figures :—

	Steel (ingots)	Cotton Piece- goods.	Sugar, (Direct from cane)	Match	Paper.
	1,000 tons	Million yards	1000 tons	Gross (Lakhs)	1000 tons.
1922-3	131	1,725	24	8	24
1939-40	1,070	4,013	1,242	220	70

It is a remarkable fact that while industrial production in most countries showed a heavy decline during the period of the great depression which started in 1929, the output of the principal industries in India showed a steady end, in some cases, a marked increase. The favourable position in which India found herself during this period as compared with countries was due largely to the fact that it was during these years that the effect of the policy of Protection began to manifest itself. Whatever criticism may be made regarding the protective policy adopted in India, the immediate success of that policy, as disclosed by these facts, deserves recognition as an achievement which testifies in some measure to its soundness and efficacy.

*Question 8* — Discuss the growth of cotton textile industry in India. Examine the effects of the present war on this industry.

*Answer.*— See answer to Question No. 10, *Economics*, 1938.

### **Effects of 2nd European War on Textile Industry:**

As everybody is aware of it, conditions in the Indian Cotton Textile Industry on the eve of the war were very bad and the millowners of Bombay and Ahmedabad were giving their thought to the question of a planned curtailment of production. The war, however, brought about a change for the better. There was very soon a rise in demand for cotton goods on account of the purchase by the Government of cloth for the army requirements, and prices in consequence gradually went up, and prosperity was soon noticed to be in the offing. But unfortunately indeed the industry could not reap the whole benefit of it, inasmuch as since the beginning of 1940 there were sundry developments to which the industry could hardly adjust itself. There were, for instance, labour troubles in various centres of the industry



and these troubles remained till the middle of April. Since the middle of April there was some recovery of course, but this did not last long. Meanwhile the Excess Profits Tax had been imposed, the railway freights had been increased, and while the situation thus deteriorated, the intensification of the war itself worsened the situation

Later on the year, however, increased demand of cloth for army requirements caused a substantial increase in productive activity and double shift working was resorted to on a large scale. There was some healthy spurt in prices too.

Production of cotton piecegoods during the first seven months of 1940-41 amounted to 2,388 million yards as compared with 2,371 million yards in the corresponding months of the previous year. Total imports during this period were 218 million yards as compared with 354 million yards in the corresponding period of the previous year. Exports during this period totalled 183 million yards as compared with 116 million yards during the corresponding period of the preceding year.

The cotton mill industry prospects for the duration of the war seem to be bright. An increased demand from the Government of India for textile manufacture for military purposes, a fall in imports of cotton piecegoods a spectacular rise in exports, a higher mill production, a good off-take of piecegoods at remunerative prices and the total elimination of Japanese competition on account of war on the Pacific are some of the features of the cotton textile industry. The mills have been working at full pressure to cater to the increased war orders. But the export demand may be affected to a certain extent because of the Far Eastern situation and the markets of Malaya, Thailand and other parts which used to import large quantities of piecegoods from India would go out of the pictures. These losses may, however, be set off by increased off-take by the European countries which were formerly being supplied by Japan and a greater extent by the U. K.

*Question 9* — Write short notes on :—

- (a) Index Numbers of Prices
- (b) Indian Trade Commissioners.
- (c) Silver contents of the rupee. .

*Answer — (a) Index Number of Prices.*—See answer to Question No. ... Economics, 1939.

*(b) Indian Trade Commissioners*—In order to develop commercial relations between India and foreign countries the offices of trade commissioners have been set up in various important commercial countries, for example, England, United States of America, South America, Australia etc., and well known persons have been appointed as Trade Commissioners on behalf of India. Each trade commissioner has in its jurisdiction several countries as, for instance, the jurisdiction of the Trade Commissioner at Milan includes Italy, Portugal, Spain, South of France, Hungary, Yugoslavia, Albania, Rumania, Bulgaria and Greece together with the adjoining Mediterranean Islands including Malta.

The functions of a Trade Commissioner fall under two main heads —

*(1) Commercial Intelligence*—It, consist in so far as the public is concerned, in attending to enquiries (i) from Indian exporter who are desirous of extending their business connections with the various countries in the jurisdiction of the particular trade commissioner, (ii) from importers in those countries desirous of importing Indian goods, and lastly (iii) from Indian importers of foreign goods which do not enter into competition with Indian manufactures and products. An allied function concerns enquiries in regard to, and the settlement of, trade disputes between continental importers and Indian exporters.

*(2) Commercial Publicity.*—This covers activities which range from organising Indian Stands at exhibitions and fairs, to the furnishing of information regarding India on a variety of subjects to official bodies, associations and individuals in his territory

*(c) Silver contents of the rupee*—Rupee is the most important metallic coin in circulation in India. It is the principal money of the realm and unlimited legal tender. Hence it may be named the standard money of India but unlike standard money its intrinsic value is less than its face value. It consists of 180 grains of silver, 11/12ths fine. It is not open to free coinage since Government makes profit on its issue. In these respects it partakes the nature of token money. It is, as such, neither wholly the standard money nor wholly

the token money. It is often described as a note printed on silver.

Early in 1941, the silver content of the rupee was reduced from 11/12ths to one-half of its total weight. In view of the increasing demand for the rupee coin consequent on increased trade activities and their absorption in hoards and the fact that rupee notes, recently introduced, were not entirely convenient or suitable for some rural areas, it was found necessary to undertake fresh mining of silver coinage on a large scale. As, however, it was extremely wasteful to turn out large quantities of rupees of the old fineness of 11/12ths silver and 1/12th alloy, it was decided that the fineness of 1/2nd silver and 1/2 alloy, adopted previously for half rupees and quarter rupees, should be adopted for the new rupees as well

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## ECONOMICS—PART 2.

1942

*Question 1* —Discuss the position of ordinary currency and bank currency in the monetary, system of England and India. ,

*Answer* —There have been and still are in the world many different kinds of money and money systems. Coins and notes belong to the order full legal tender money or as we call it for short legal tender—that is, money which is certified by law to be valid in final discharge of a debt for any amount from one fellow citizen to another while bank money or cheques belong to the order optional money which is not so certified at all. Currency notes are freely accepted because of the confidence of the public in their convertibility into gold or silver. But all the exchange transactions for which money is required are settled not by the use of gold coins or bank notes. A large proportion of the mercantile transactions is effected by means of book credit. The importance of book credits may be indicated by the huge figures of the cheques which pass through the clearing houses of the different countries. When it is remembered that in addition to the visible figures of the clearing houses there is a considerable value of the cheques which fail to pass through the clearing houses, some notion is obtained of the extent to which the exchange business of the country is effected, by means of bank credit. In England, banking has much progressed and banking habit is much developed. The use of bank credit is common in England for settling exchange transactions whereas in India most people do not realise the benefits of the use of cheque currency and still hesitate to accept it in settlement of claims.

Institutional conditions set ultimate limits to the use of each form of currency. But within these limits considerations of convenience, average size of transactions, per head income, level of prices etc influence the use of each and there are grounds that these factors have changed considerably in the last forty years. Yet between currency notes and chequeable deposits the former still exceed the latter which are slowly gaining over them. In towns and big cities the use of cheques is becoming popular and a very large number of transactions is settled by transfers in bank books but in the villages and rural areas, currency notes and rupees are the principal mode by which debts are settled.

**Question 2.**—Examine the principles on which the cash reserves of banks are maintained. Give illustrations.

**Answer**—The chief danger to a bank's solvency arises from its inability to meet demand obligations. The bank must therefore keep in reserve in cash, or what is actually equivalent to cash, a sum sufficient to meet all probable demands for cash. This is called the reserve. It must not be confused with the 'reserve' which is equivalent to what we term the 'surplus' or with the 'reserve capital' which is often used to designate the 'unpaid capital'.

Since the cash reserve is designed to meet immediate obligations it must be composed of cash or something that is instantly convertible into cash. 'Gilt Edged' and Government Securities are no substitute for a cash reserve because in times of trouble they may not be saleable at any price.

The extent to which cash reserve should be kept by a bank is a delicate question. Sometimes a bank finds very few demands made on it for cash and plenty of idle cash lying in the vault, a sight rather painful to the banker. On other occasions, large sums of cash are withdrawn and the bank finds its cash resources rendered very thin. The bank must keep all these circumstances in view. It has an idea of what its till money is from day to day.

A bank cannot refuse to honour the cheques of its customers. The Bank has, therefore, to keep a sufficient cash reserve to meet any possible rush or run of depositors on it. The amount of such a reserve would depend upon the attitude of its clients, the nature of its deposits (whether they are in current account or for fixed periods, its reputation for its integrity, its financial strength. These qualities are different for different banks. A cash reserve of 5 per cent may be quite sufficient for one bank but for another even a bigger reserve might be small. Under all circumstances, however, the assets of the bank should be so distributed that in the event of unusual rush or even panicky demands for cash these assets can be quickly mobilised. The ability of the bank to find ready cash to meet possible abnormal requirements of its customers is a vital point and this item may be regarded as the bank's first line of defence.

What should, however, be the percentage of actual cash holdings to the deposits is a question whose answer surely cannot be given in very definite words. It depends

upon the nature of the community that the bank serves and that of its investments. In certain cases it also varies with a variation in the season. Nevertheless, every bank manager has in his mind's eye a conventional percentage which is his best endeavour to maintain knowing that every reduction below that percentage reduces his margin of safety and every excess reduces his profits. The following factors determine the percentage of cash resources to demand liabilities —

1 The size of the cash reserve of a particular bank depends upon the average size of the deposits of its customers. It shall have to be such as will enable it to meet heavy withdrawals of the depositors having maximum amount of deposits.

2 If cheque habit is sufficiently developed and demands are not adequately made in cash the amount in reserve may be smaller than otherwise is the case.

3 If clearing system is well developed most of the cheques are settled by transfers through the clearing house and the necessity of keeping high cash reserves is avoided.

4 If banking habit of the people of the place is sufficiently developed and they are not used to hoarding, there is a constant inflow and outflow of funds into and from the banks, it means that the banks can carry on smaller cash reserves than is possible if otherwise is the case.

5 If the customers of a bank belong to such classes as Bill Brokers and Discounting Firms whose accounts are of fluctuating nature a larger cash would be required to meet the heavy withdrawals.

6 If the investments of a bank are such as can be easily liquidated a smaller cash reserve would be necessary as the investments would be available whenever funds are required.

7 Finally, if banks are situated in Commercial area they are required to keep much larger cash than if they are situated in an agricultural area.

The proper amount of the reserve is sometimes fixed by law. In India, the scheduled banks are compelled to keep 5 % of their demand liabilities and 2½ per cent of their time liabilities with the Reserve Bank of India.

**Question 3.**—Why do prices rise during a war? What is meant by Price Control. How far can it be effective in India?

**Answer.**—War brings about great changes in the demand and supply curves of a large number of commodities. The demand for war goods, armaments and other allied goods, increases tremendously. Trade with belligerent countries ceases, the supply of goods imported from them decreases, the demand for goods exported to them diminishes. Trade with neutral countries is also affected. Either due to their natural sympathies or due to their geographical situation, exports to them and imports from them undergo a great change. The priority which has to be given to war goods in allocating transport facilities creates further disparities between demand and supply. Due to the transport shortage, not only is the trade with foreign countries affected, but even the internal market is often divided into a series of local markets, each with a price of its own. The movements in population due to the direct necessity of war or due to the need to move from comparatively dangerous areas to safe ones put a further strain on transport and aggravate the difficulties of transport shortage. All these factors lead to great changes in prices in war-time. And since the most important factors in the situation is the Government demand for war goods, the general change in prices is a change upwards; i. e., a rise in prices.

In normal times, a rise in prices fulfils a very essential function. It restricts the effective demand to the available supply, and by stimulating the producer to produce more, serves to bring up the supply to the level of the present demand in future. In war, however, this function becomes obsolete in many cases. In a modern totalitarian war, there are no limits to the demands of the Government. It is ready to absorb as much of war goods as can be produced. Thus, there is no possibility of the supply catching up with the demand, and thus establishing a normal balance between the two. Even if this were possible, the Government would not consent to private parties making a fortune out of a public calamity. With regard to a rise in the prices of civilian goods, especially, necessaries, the same considerations hold good. A rise in their prices leads to a greater demand for dearness allowance, thus leading to constant labour trouble, or wages and prices pursuing each other in a vicious spiral. The Government, therefore, has

to take measures to check a rise in prices, i.e., to control prices.

The extent to which price control measures may be effective will depend on the particular cause of the price rise, the nature of the goods affected, etc. the easiest rise to control is the speculative price rise, which is not warranted by any inherent conditions, i.e., by any supply or demand conditions. Such a rise is only due to the stocking by the middlemen in the expectation that prices would rise in future, or due to their desire to create an artificial temporary shortage taking advantage of the consumers' ignorance. If stern measures are taken against these profiteers and alternative methods of distribution like cheap gram shops opened up, this price rise can be easily checked. The steps taken by Government in this country to control prices during the early stage of the war were fairly effective.

The rise that takes place in the goods demanded by the Government is also easily checked though it may be due to real conditions of the market. The Government is, very often, the sole buyer here, so that there is no question of an allocation of supply. Where private buyers are competing with the Government, the Government can easily get over the difficulty by shutting them out altogether, or by decreasing that only what is left over after Government orders have been satisfied can be sold to private consumers, or if several kinds of goods are produced by the same manufacturer the Government may compel the producers to reserve a certain part of their productive capacity for production of goods demanded by the Government, as is the case in India with the textile manufacturers at present.

The most difficult case is the real price rise in civilian goods. Here if the natural mechanism of price rise to equate effective demand to supply is dispensed with and measures taken to reduce demand, the result will be queues of people quarrelling amongst themselves before the shops and an unsatisfactory distribution of the available supply.

It is, therefore, imperative in such a case to arrive at some rationing system artificially to restrict the demand. But to introduce any satisfactory rationing system a knowledge of the amount produced and the consuming habits of various sections of the people is essential. This information is lacking in India in the case of many commodities. Hence, the great



difficulty of our price control and the great possibilities of its proving ineffective.

*Question 4.*—Why did the value of the rupee change (a) during the last war (1914-18).

*Answer* —Upto the year 1850 the relative value of gold and silver was fairly steady. Thereafter for about twenty years the ratio was in favour of silver. From 1871 a gradual fall in the gold value of silver became noticeable in the world's market. Not only the production of silver increased but that of gold had fallen. Further several European countries, Germany, Sweden, Denmark and Norway demonetised silver from their country. The output of silver from new mines began to flow into India and had to be freely coined by the Indian Mint. It was opened for free coinage and the people considered it profitable to convert silver bullion into silver coins. The fall in the gold value of silver opened a new chapter in the monetary history of India and its effect was felt by India more than by any other country. The general level of prices began to rise and the price of silver fell from 58d. per ounce in 1875 to 27 per ounce in 1899. With the fall in the value of silver the exchange value of rupee in terms of the sovereign began to decline for the importers of Indian commodities could now pay their debts with silver and the consequence was a steady flow of silver into India. Between 1874 and 1880 the gold value of silver fell from 22 3d. to 19.9d. This depreciation in the value of the rupee produced an embarrassing situation in India. In the first place India's foreign trade was unsettled. Every fall in the value of rupee encouraged exports and discouraged imports. Secondly, the finances of the Government were unsettled. As Government had to remit Home Charges which were payable in gold all calculations in the budget regarding payment for home charges were upset by the fall in the value of rupee and heavier taxation in rupees had to be resorted to for covering the budget deficits. In the words of a finance member, Indian Finance in the eighties was a gamble in rains and exchange.

The continued fall in the value of the rupee led to the appointment of the Herchell Committee who were called upon to pronounce their verdict on the silver standard.

### Currency Position in 1914 to 1918

Before the recommendation of the Chamberlain Commission could be considered by the Government the Great

War broke out and all the proposals for reforms had to be delayed. The Indian Currency system stood successfully the strain of the war during the first two years. The currency trouble commenced towards the end of 1916. There was in the first place, a good demand for Indian commodities by the allied countries. The prices of commodities had risen considerably not only in Europe but also in India. (2) At the same time, partly owing to difficulties of transport and partly owing to a reduction in the supply of imported commodities, the balance of trade largely turned in India's favour. The liquidation of this favourable balance of trade presented very serious difficulties. (3) Normally India received a considerable amount of precious metals in settlement of her favourable balance of trade. But the embargo imposed by many European countries upon the export of precious metals rendered the liquidation of India's favourable balance extremely difficult. There was, therefore, a great and persistent demand off the value of Indian merchandise. But it was not possible for the Secretary of State for India to sell unlimited quantities of Council Bills. Owing to heavy disbursements by the Government of India on behalf of the Home Government, large funds had accumulated with the Secretary of State for India. (4). During the war, India was made the base for the supply of munition to the eastern theatre of the war, viz. Mesopotamia and East Africa. The Government had to purchase munitions and pay for troops engaged in those parts. The expenditure was incurred on behalf of the Home Government and the arrangement was that the Home Government would pay the Secretary of State for India. As the Secretary of State for India got money from the Home Government, it was not necessary for him to sell Council Bills for expenditure on Home Charges.

Further, there arose a new and unforeseen factor. The price of silver in the London market began to rise heavily and by August 1917 it rose above parity. The Secretary of State for India could not, therefore, sell Council Bills at a rate which did not cover the cost of the coinage of a new rupee.

The prices of silver continued to rise till it reaches the peak figure of 800 per ounce. It was impossible for the Government to maintain any fixed ratio between gold and silver and all attempts to stabilize the value of silver rupee failed. In December, 1919, the exchange rose to 23d per rupee. The Government bought 200 million ounces of silver from U S A. and economised the use of silver by issuing 2½ and Re. 1 notes and nickel coins of lower denomination. However, the

net impact of war was the breakdown of the Gold Exchange Standard.

The rise in the price of silver introduced very serious complications in the Indian currency system. Under the Gold Exchange Standard, Government were legally bound to pay rupees for gold at the rate of Rs 15 for a sovereign. With the lowering in the price of gold, it became profitable to import gold and present it to Government for conversion into rupees, and to export rupees as bullion. This situation had to be met by acquiring all gold at the current rate of exchange, as otherwise there was a danger of rupees being drained away from India. Another complication that manifested itself was the run on the rupee reserve for maintaining the convertibility of notes into rupees. Government were confronted with the risk of inconvertibility of the Indian Paper Currency. Even the arrival of the silver from America under the Pittman Act did not reduce the demand for rupees which continued throughout the year 1918. The legal convertibility of the rupee was, however, maintained by various artificial methods.

*Question 5* — Discuss the relative positions of the Reserve Bank of India and Imperial Bank of India in the Indian money market.

*Answer.*—Prior to the establishment of the Reserve Bank of India in 1935 India had a dual system of control over her credit and currency. The Government controlled the currency and the credit situation, so far it was controlled at all was controlled by the Imperial Bank of India. Divided control meant divided counsel and failure to co-ordinate. With the inauguration of the Reserve Bank the control of both credit and currency was placed in the hands of a single authority. The Reserve Bank of India Act 1934 sought to put an end to the leadership of the Imperial Bank on certain lines. The Reserve Bank assumed the control of the money market but working as it is in a country of non-homogenous conditions it has not come to the expectation and has failed to exercise the same full control over the Indian money market as the Bank of England does in the London money market. The Reserve Bank discount rate is ineffective for all practical purposes. This is due to the fact that the bank rates does not permeate the entire banking system. The money market in India is divided into two parts: the European and the Indigenous. There is no cohesion between these parts of the market and there are frequent differences between the bank rate and the bazar rate. When the

Reserve Bank rate was reduced to 3% per annum the Imperial Bank rate remained at  $3\frac{1}{2}\%$ .

The Reserve Bank of India is no doubt a banker's bank but on account of its having a limited number of branches the other banks deposits kept with it are most very large. Imperial Bank of India has, on the other hand, a large number of branches spread all over the country. Its private deposits amount generally to more than a third of the aggregate deposits of banks in India. A bank with such enormous resources, expense and strength could always be sure of forcing others to lead when such lead was in conformity with operations circumstances. Moreover its connection with the Government gives its command over large and dependable volume of public funds. It is a semi-bankers' bank. The other banks have their overdrafts mostly with the Imperial Bank and as already stated above, it is the Imperial Bank advance rate and not the Reserve Bank bank rate which is of prime importance in controlling the money rate in the money market at most of the places.

*Question 6* —What are the principal methods by which the States can help industries? Which do you advocate for India after the present war?

*Answer* —The poverty of India is notorious. It is also colossal. Such is because India's production is low. Its manpower is untrained and unorganised. A majority of the population is illiterate. The country depends for its subsistence mainly on agriculture. India's industrial development has not received all the attention that it needs. India stand far behind the other countries of the world so far as the industrial position is concerned. The pressing problem that faces the country is low to convert her from an agricultural country into an industrial one. This can be done by launching a scheme of industrialisation based on a nation-wide plan supported all its way by the Government. Sir M. Visweswraya, the President of the All-India Manufacturers' Organisation, Bombay, has suggested a plan for industrialising the whole country on a regional basis. The scheme as envisaged by Sir Visweswraya, is based on the classification of industries into three types, viz., large scale industries under which come those industries requiring a capital of Rs 30 lakhs or more while, for medium scale industries, the outlay needed would be between Rs 1 lakh and Rs 30 lakhs. Industries with an invested capital of Rs 1 lakh or less are included under small-scale industries.

The reason why large scale industries should be established, according to Sir M Visweswraya, is that they eliminate the economic waste inherent in a country's excessive imports. He, therefore, proposes that every Provincial Government should undertake one or two large-scale key industries according to local needs and the resources at its disposal. In order to start such key industries, we are told, it requires only about three years' time. The most important of such large-scale industries include ship-building, railway locomotives, power machinery, automobiles and aircraft, industrial machinery, armament production, machine tools, chemical industries, agricultural machinery, aluminium and dyestuffs. If the country's needs are to be adequately met, observes Sir Mokshagundam, preparations for the establishment of a large number of the type of industries mentioned above should be commenced, without further loss of time, by the Government constituting a proper Post-war Reconstruction Board or Committee with a competent executive staff under the guidance of a trusted industrial leader as Chairman.

Medium-scale industries can be fostered by private enterprise, continues Sir Visweswraya, by non-official industrialists and businessmen, and all that the Government need do in this sphere, according to him, is to extend protection from foreign competition as far as it lies within its power. It could also help by granting subsidies, contributing share capital, and if possible, guaranteeing interest on capital for a limited period. Medium-scale industries have not prospered in India, opines the veteran engineer-statesman, and because of ignorance regarding the elementary scientific principles and business practices necessary for securing a profitable return. There is also lack of reliance, information and adequate statistics to guide enterprising industrialists in shaping their policies in a planned fashion.

Small-scale industries, in the opinion of Sir Visweswraya, are of special value to the rural population as a source of income in the period of unemployment. The small man and the home industry still hold a primary place in village economy. Lack of capital is an eternal problem with the farmer. Requisite financial facilities should, therefore, be provided to him, and progress from year to year watched and reviewed by maintaining reliable statistics. Care should be taken to encourage, at first, only such cottage industries in a given area as would directly assist the rural population to meet its subsistence needs. The production of luxury goods, it is suggested, should be avoided as far as possible for the

next ten years or until an appreciable rise is secured in the standard of living of the people. This advice is particularly noteworthy.

*Question 7* — Examine briefly the nature and amount of industrial development in India since the policy of Discriminating Protection was introduced

*Answer* — The policy of discriminating protection has been severely criticised by a section of the people but one cannot minimize the importance of the policy to the industrial development of India. Whatever achievements India may be able to claim in the future the work of the Tariff Board in the country will continue to be regarded as the necessary foundation for the edifice of Indian industry. The Indian Tariff Board is the natural result of the decision of the Government of India after the Great War to change the fiscal policy and adopt a policy of Protection to be applied with discrimination. This decision was based on the findings of the Fiscal Commission that the industrial development of India had not been commensurate with the size of the country, its population and its natural resources and that the fullest development must be aimed at by a policy of judicious protection. The Fiscal Commission also laid down the guiding principles of such a policy and recommended that in its application the Government of India should be advised by a Tariff Board. The procedure in the case of a Tariff Board enquiry was simple. The Tariff Board should satisfy itself regarding the following conditions before recommending protection to an industry

1. The industry must possess natural advantages, such as an abundant supply of raw material, labour or cheap power or a large home market. No industry which does not possess certain comparative advantages will be able to compete in the long run. No industry should be protected, which is likely to become a permanent burden on the community.

It must be proved that the industry cannot make progress or its progress is likely to be slow unless protection be granted to that industry. The object is to develop those industries, which otherwise would not have developed and to develop them with greater rapidity.

(3) The industry must be such as will ultimately be able to face world competition without protection. In other words protection is to be a temporary measure.

The Board has so far undertaken and accomplished a wide range of enquiries. Of these, in only few cases have its recommendations failed to meet with the acceptance of the Government. Wire and wire nails, which was one such, subsequently gained the protection it sought. In the heavy chemicals industry, the publication of the report was delayed for two years after its submission to Government, after which it was granted tentatively a somewhat grudging measure of protection. In a number of instances, the applications were turned down by the Tariff Board, and the Government acquiesced in its decision. In the case of magnesium chloride, coal and printers' ink, it was held that the case for protection was not established, though the latter gained its object through a slight increase in the import duty. Cement failed to procure State help as it was found that what the industry suffered from was not the competition of foreign producers but a state of overproduction at home, a position which it was for the industry to adjust as soon as and as well as possible. The most outstanding instance is this category of rejected applications is that of oil, in which not only were the producing interests unable to establish a case for protection but a certain section of them was found to be unwilling to place the full facts before the Board. There were cases in which import duties on raw materials needed for Indian industries were either reduced or removed. In all the other cases, the applications have resulted in the grant of a substantial measure of protection. But the chief beneficiaries of the activities of the Tariff Board have been the Cotton Mill industry and the iron and steel industry. To this may be added sugar because of its being a prime necessity and having an equally important place both in the agricultural and industrial life of the country. All these three industries have, on the whole, made good use of the advantages conferred on them by the State. The cotton mill industry is much older than the policy of the discriminating protection. And one would expect that the additional advantage of protection would enable the industry to outgrow the need for these much sooner than other industries. The industry has expanded considerably and is now in a position to satisfy to a large extent the country's demand for every kind of cloth. The Iron & Steel industry has been hundred per cent. successful under protection. Not only have the protective duties been withdrawn in some cases but the Tariff Board has actually recommended the abolition of revenue duties.

The sugar industry has made a rapid progress in the short period of protection. Within a year of the inauguration

of protection for sugar it was clear that in this instance protection had led to abnormal expansion and it was in the interest of the industry to put a curb on such expansion. The Government of India also found that the import duty on sugar comprising as it did, both the protective duty recommended by the Tariff Board and the revenue surcharge, was so effective in checking the import of sugar from abroad that the Government's expectations of revenue from this source were not realised. So in the last quarter of 1933-34 Sir George Schuster came to the conclusion that in the interest both of the industry and of revenue on excise should be levied on sugar, leaving the net amount of protection at the level recommended by the Board, so that, it will be seen that protection has been successful not only in bringing the sugar industry into existence but also in including its vast expansion within a very short period.

The matches and paper industries owe their present position to the sheltering care of protection enjoyed by them. There is an excise duty on the manufacture of matches.

There is no doubt that protection has helped a number of industries in India. But the number of industries that owe their growth to protection can be counted on tips ends. There is a strong feeling prevailing in India that Discriminating protection is a halting and a half measure for industrialising the country. The recommendations of the Tariff Board are not always accepted by the Government, as for example, glass industry has not been given protection although the Tariff Board recommended it. Discriminating protection is further diluted by the policy of Imperial Preference which has been accepted by the Government.

*Question 8* --The imports of a country are paid for by export. Explain this statement and illustrate from Indian conditions.

*Answer* —See Answer to Question No 7, Economics—Part II, 1936

*Question 9.*—Write short notes on (a) Inflation, (b) Exchange Control, (c) Terms of Trade (d) Key Industries.

*Answer (a) Inflation* —Inflation may be defined as an abnormal and deliberate expansion of currency and credit beyond the amount necessary for the requirements of trade at the prevailing level of prices. To put it in the words of Walker, 'A permanent excess of the circulation money of a country, over that country's distributive share of the money of the



commercial world, is called Inflation." It is quite distinct from the ordinary expansion necessitated by the increase in trade or population.

The value of money depends upon the relation of supply to demand, an increase of notes issues implies a loss of value in each given quantity of money. This involves rise in prices. The creditors are defrauded although there is a corresponding gain to the debtors. The rising prices of commodities increase the profits of the producers and thus stimulate business. Profits are increased because cost of production does not increase as quickly as prices and so the rise in prices increase the margin of profit. The uncertainty of the extent of the depreciation, however, makes notes a bad standard for deferred payments. Trade is rendered uncertain and speculative. Inflation thus becomes a highly destructive force within the field of industry dealing a grievous blow at the organisation of the industrial body for the purposes of production and exchange.

(b) *Exchange Control* means operations undertaken by monetary authorities for purchase and sale of exchange for a definite purpose, like the maintenance of a certain exchange level, between two or more currencies, or exchange embargo or restrictions or special organisation created to develop a certain monetary or exchange policy. But in its widest sense it includes all those methods through which a Government or a Central Bank tends to give to its country's currency an external value higher than what Cassel would call the "parity rate." But an attempt to maintain a disparity between the actual rate (likely to result from the forces of supply and demand) and the artificial rate (which is the result of exchange control) must be followed by a drain on the gold reserves of the country and so the function of Exchange Control is to prevent the outflow of gold. It, therefore, rests upon the exchange Control to remove the disparity between the two rates and alter the underlying forces in such a way that the artificially controlled rate becomes in the long run the actual equilibrium rate when there will be no further need to prop it up with special support.

Exchange Control has a wide signification and embraces a large field of monetary activities with exchange, financial economic and even political objectives. The organisation through which these objectives are achieved may be the Central Bank or any special organisation, exclusively official or semi-official.

(c) *Terms of Trade.*—Terms of trade may be defined as the rate at which the exports of a country exchange against her imports. Let us explain it with the help of an example. Suppose there are two countries A and B engaged in the production of two commodities, tea and linen respectively. For country A, the opportunity cost of producing 1 unit of linen is 1 unit of tea. She will therefore be prepared to exchange some tea for some linen at any rate which gives her more than 1 unit of linen for every unit of tea exported. For country B, the opportunity-cost of producing 1 unit of tea for less than 2 units of linen. This means that the terms of trade between the two countries will lie somewhere between the opportunity-cost ratio in each. One unit of tea, that is, will exchange for more than 1 unit but less than 2 units of linen. Exactly where the ratio will lie between these two limits will depend upon the relative demand for tea as against linen in both countries.

Terms of trade lie at the basis of international trade. These are not fixed but may change as time goes on.

(d) *Key Industries.*—Key Industries are those industries the products of which are of great importance to a country and on the existence of which depends the industrial prosperity of that country. In India, key industries are those or Iron and Steel, Cotton, Textile, Chemical etc. In certain cases the products of these industries are utilised as raw materials by numerous other industries.

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## ECONOMICS—PART II.

1943

*Question 1* —How is the value of money determined? Why does the value of money change? Give illustrations

*Answer* —Like the value of every commodity, the value of money is determined by the demand for, and the supply of, money. Since money has no value in itself, because its utility is not direct, but derived from its purchasing power over commodities in general, it has been concluded, rather hastily, that the elasticity of demand for money is unity—the belief more popularly known as the quantity theory of money. But this is untrue. Money has value not only as an immediate buyer of goods and services, but has also a deferred value. Money serves as a store of value in modern times. It may, therefore, be that at certain times the demand for money may become greater than unity. This will be specially so, when prices are falling rapidly. People anticipating a still further fall in prices will postpone their buying and store their money, the liquidity preference for money will go higher, and the price level will fall even if the money volume is not contracted. The contrary will happen in times of rising prices. Expecting a further rise in prices, people will prefer to hold and hoard goods, there will be a flight from money, and prices will rise even when there is no rise in the quantity of money. If these changes had no connection with changes in the quantity of money and occurred independently, the quantity then would not have been vitiated, it would have only to be stated more carefully with the saving clause “other things being equal.” Unfortunately there is almost a causal connection between the changes in the quantity of money and changes in the liquidity preference of the community: A rapid rise in the quantity of money leads usually to a tendency to hoard, which further raises the prices. This is what happened during the post-war inflation in Germany, when the price of the commonest article was quoted in millions of marks. Something similar happens during the upswing of the trade cycle. Conversely when the quantity of money is reduced, the price level will fall much further than that warranted by a decrease in the quantity of money.

We have seen so far a factor which aggravates the rise or fall in value of money compared with the decrease or increase in its quantity. But there are also factors which may

cancel or modify this effect. An increase in the quantity of money at a time when resources are not fully explored may bring about a rise in production and thus prevent the rise in prices.

The value of money being thus determined by demand and supply, any factor causing disturbance in either will mean a change in the value of money. Only some of these are given below for illustrative purposes.—

(a) *Currency*.—Due to various reasons, the State or the central banking authority may decide on an expansion in the currency circulation. It may be that the State cannot finance, as is the case in India to-day, its expenditure—without resort to the printing press, or it may only be in response to the increase in demand for money. If the currency in circulation increases, (other things being equal, the price level will increase, the additional currency having now to perform the same work as before, its value will go down. The reverse will happen in a case where either in efforts to maintain the foreign exchange rate or otherwise, the State contracts the currency circulation.

(b) *Credit*.—Credit in modern times plays an increasingly important role in deciding the value of money. Though due to the legal rules in some States and due to the convention in most, the banks maintain a certain ratio of their cash in hand to liabilities, they cannot be forced to lend always up to the maximum amount. Where the ratio is conventional, the freedom is much greater. If the psychology of depression has gathered force, the banks may not like to involve themselves in risk, and will prefer to have a larger amount of idle balances. In normal times, they will be satisfied with the minimum. An increase or decrease in currency circulation may, therefore, be reinforced by a parallel movement in credit, or be counteracted by an adverse movement in it.

(c) *Velocity of Circulation*.—In determining the value of money, it is not the quantity of money that is important, but the quantity of money used per unit of time. A penny with a quick turnover may do more work than a hoarded pound. In general, the greater the tempo of industrial life, the greater will be the velocity of circulation. In a village the velocity will be much less than in a big town. In boom times, the velocity will be much greater than in a crisis.

(d) *Change in Production and Trade.*—Other things being equal, an increase in production and trade will mean an increase in the demand for money and, therefore, an increase in its value. A decrease in production and trade will mean a decrease in the value of money. It is for this purpose that an increase in currency and credit is considered advisable when there is an increase in production, otherwise, falling prices may have a damping effect on business.

(e) *Change in Business Conditions.*—More important perhaps than production is the change in business conditions. From the viewpoint of the value of money, it is the number of transactions for which it has to be exchanged that is important. A change over from credit transactions to cash will thus mean a rise in demand for money and, therefore, a rise in its value. Similarly, a greater vertical integration of industry will eliminate some demand for cash, thus having an adverse effect on the value of money.

*Question 2*—Describe the operation of a trade cycle, illustrate from Indian conditions.

*Answer.*—See Answer to Question No 1, Economics 1937.

*Question 3.*—Examine the effects of the war on Indian currency.

*Answer.*—The position of Indian currency on the eve of the war was determined by the provisions of the Indian Currency Act of 1923, the subsequent order of 1931 delinking the rupee from gold and linking it to sterling and the Reserve Bank of India Act 1935. The Reserve Bank of India is in sole charge of the issue of paper and is also under a moral obligation to give rupees in exchange for its notes; it is required by law to sell and buy sterling at the rate of 1s. 6d. a rupee; and its reserve position was statutorily determined to the effect that it must not have less than 40 per cent corn in the form of gold and sterling of which gold was to be of value not less than 40 crores. The rest of the reserve could be in the form of rupee, securities, rupee coins and trade bills, the former not to exceed the sum of Rs. 50 crores. It was also laid down that the reserve of rupees should be kept at Rs 50 crores any reductions in the same being replenished by

the Government of India. The statistical position regarding currency in India on the eve of the war is given below :—

(Figures in lakhs of Rupees.)

*Liabilities :*

Total note issue	... 216,78
Notes held in the Banking Department	... 37,89
Notes in circulation	... 178,89

*Assets*

Gold coin and Bullion	... 44,42
Sterling securities	... 59,50
Rupee coin	... 75,47
Rupee securities	... 37,39

Total Assets ... 216,78

The percentage of gold and sterling to total note issue was 47.9 per cent or well above the statutory minimum.

But war is a very disturbing factor. It upsets almost every walk of life. In particular it plays havoc with the monetary mechanism of a country. The effects of the war on the currency have been very grave and are even now causing headache to the Indian economists. These effects may be considered in five divisions —

- (1) Scarcity of rupee coins.
- (2) Scarcity of smaller coins.
- (3) Inflation of currency, and
- (4) Accumulation of sterling balances in London
- (5) Change in the paper currency.

The scarcity of rupee coins was the first currency problem that our country had to face after the war started. As soon as Great Britain declared war on Germany, there was a rush to convert bank notes into silver rupees. There were signs of half-hearted confidence in the British Government and the conversion was supposed to give some safety to savings. The early British reverses helped to strengthen this tendency. The conditions became really critical after the

fall of France in the summer of 1940. In the beginning the Reserve Bank met all the demands fully and without any check. But by the middle of 1940, its rupee stock was greatly depleted and there was need of changing the policy. Consequently help was taken of the Defence of India Rules under which hoarding of rupees was made illegal. This did not succeed in reducing the demand for silver rupees. The Government then issued non-convertible one-rupee notes. Subsequently the silver contents of the rupee and half-rupee coins were reduced as the rise in the market price of silver made the melting of these coins a profitable business. At the same time, old and heavier rupee coins bearing the stamp of Queen Victoria, George V, Edward VII and George VI were withdrawn from circulation. In 1941, the Government had to issue two-rupee notes. By all these measures, the problem of the demand for rupee coins was at long last successfully solved.

The solution of the problem of the demand for rupee coins was perhaps one of the causes of creating a scarcity of smaller coins. When the hoarding of rupee coins was made illegal, people, particularly villagers, began to hoard smaller coins. The Government, indeed, made much of hoarding later and stated that hoarding was the only cause of the scarcity of small coins. This was not altogether correct for as soon as the Reserve Bank refused to give small coins for more than two rupees at a time and the Government took strong action against hoarders under Defence of India Rules, such hoardings as did exist were brought to light. The real reasons of scarcity were the increased purchasing power with the masses, the rise in prices and the payment of daily wages to a very large number of freshly employed workers. All these factors increased the demand for small coins. But the Government failed to supply quickly. There was lack of metal to make coinage possible. As such small coins of heavier varieties were withdrawn through railway and post offices and were melted down to coin light-weighted coins. This increased the scarcity for sometime. It was only when the Government realised their mistake and increased the supply of such coins considerably that the situation eased. But even now the shortage of small currency is continuing though fortunately it is not as acute as it was sometime back.

The most striking effect of the war on the Indian currency system has been the accumulation of sterling in London and expansion of currency in India leading to inflation and its consequential serious effects of Indian economy.

Our sterling balances increased due to two reasons. One was the favourable balance of trade in private merchandise in India's favour which was not sought to be checked either by the Government of India or the Reserve Bank. The other was the vast supplies of stores and services which India was supplying to His Majesty's Government. The Government of India were acting as the agents of His Majesty's Government and obtaining payments in sterling, this sterling was sold by them to the Reserve Bank of India who issued rupee notes in exchange, and the rupee finance thus obtained was used by the Government of India to make payments to the Indian suppliers of goods and services.

The large increase in sterling balances was necessarily followed by a vast increase in the volume of Indian currency; and as this additional currency, by the very nature of its creation found its way into the hands of the public and got added to the effective volume of purchasing power in the country, it had the effect of pushing up the level of prices in the country.

With an increase in note-circulation a corresponding increase has been brought about in the paper currency reserve as well, (a) Rupee coins include now one rupee notes also; (b) the limit to the holding of rupee securities originally prescribed in the Reserve Bank Act has been withdrawn and (c) gold holdings in London have been cancelled by a transference of the gold holdings of the Bank of England with the Reserve Bank for India to the paper currency reserve (d) the percentage of the holding of sterling securities in the paper currency reserve has been going up despite their transfers in connection with the repatriation of sterling debt mainly because of India's favourable balance of trade and purchases made and expenses incurred by the Government of India on behalf of the allies.

The statistical position regarding currency in India at the end of March 1946, was as under and it may be composed with the table given in the beginning —

(Figures in Lakhs of Rupees).

Total note issue	...	1,238.66
Notes held in Banking Department	...	21.74
Notes held in Issue Department	...	1,216.92



*Assets :*

Gold coin and bullion	...	44,42
Sterling securities	...	1,123,32
Rupee coin	...	13,08
Rupee securities	...	57,84
		<hr/>
Total Assets	...	1,238,16
		<hr/>

*Question 4* — Discuss the relation of the Central Bank of a country with the ordinary banks.

*Answer.* — The Central Bank of a country is always a bankers' bank and is the custodian of the Commercial Bank's Cash reserves. This function has devolved upon it by a process of devolution which was closely associated with its functions as the bank of issue and the Government's banker.

The centralization of cash reserves in the Central Bank is a source of great strength to the banking system of any country. Centralized cash reserves can at least serve as the basis of a larger and more elastic credit structure than if the same amount were scattered among the individual banks. It is obvious that when bank reserves are pooled in one institution which is, moreover, charged with the responsibility of safeguarding the national economic interest such reserves can be employed to the fullest extent possible and in the most effective manner during periods of seasonal strain and in financial crisis of general emergencies.

The centralisation of Cash reserves is conducive to economy in their use and to increased elasticity and liquidity of the banking system and the credit structure as a whole but only in an indirect manner. It is, in fact, the Central Bank's function of rediscount facilities to the Commercial Banks and lender of last resort which directly serves to promote such economy, elasticity and liquidity. In the absence of a Central Bank and centralised reserves each of the Commercial Banks would, for example, have to carry more cash in order to cope with seasonal strains and possible emergencies than if there were a Central Bank from which the Commercial Banks could directly or indirectly and individually or collectively obtain the necessary accommodation at such times.

The important point about centralised cash reserves is, however, that they serve to increase the capacity of the Central Bank to rediscount or otherwise create credit for the purpose of meeting the cash requirements of the Commercial Banks or the money market generally

The obligation imposed on Commercial Banks to keep minimum cash reserves in the Central Bank gives the latter a minimum amount of funds with which it can operate and this not only strengthens its financial position but also gives it some means of control over the banking and credit situation.

In addition to minimum statutory cash reserves, a Central Bank is also entrusted by the Commercial Banks with the custody of their surplus cash reserves because of the convenience and other advances which accrue therefrom to banks individually and to the banking system as a whole

It is urged that on account of the legal or moral obligation of Commercial Banks to maintain minimum balances with the Central Bank [the latter is morally obliged not to compete directly with them since in doing so it will be using their own funds against them and can under quote them because of its paying no interest on their deposits. The argument has some value of truth but it is very seldom that a Central Bank would enter into the market as a free competitor to the Commercial Banks.

It may be said in conclusion that the relationship between the Central Bank and the Commercial Banks must be based on free and full co-operation to their mutual advantage and that of the country as a whole and on the willing acceptance of moral obligations by both positions. In the common interest the Commercial Banks should keep their surplus cash with the Central Bank while the latter has a moral obligation not to abuse the additional strength and power which it derives from its holding the Commercial Bank's Cash reserves

*Question 5* — How does the Stock Exchange help (1) the investor and (2) the industrialist ?

*Answer* — The Stock Exchange is an important constituent of the money market. It is a market where the invested capital in the form of stocks and shares is bought and sold on the basis, not of their original value, but of their actual value determined by present and prospective earnings. A good Stock Exchange market is indispensable in the

present times. It is here that an investor can employ his funds in easily saleable securities at the same time earn interest on his investment. Without a ready market persons holding shares in industrial concerns would not be able to turn up locked up capital into readily available purchasing power. The Stock Exchange is a market for capital already invested and so an investor can buy shares and stocks according to his choice. But it is not merely investors who buy stocks and shares but also speculators. While the investor is interested in the yield of the security he buys, the speculator hopes to make a profit by selling it again. A Stock Exchange is thus subject to the influences of both investors and speculators. The speculation may and sometimes do cause such heavy disturbances on the Stock Exchange by these speculative activities that the prices of even first class shares are so much depressed that an investor's calculations which he may have made as regards yield on his investment at the time he purchased the securities, are entirely upset. In spite of this disadvantage a Stock Exchange is a boon to the real investor in modern times.

The Stock Exchange is not a market for new capital. Yet it enables capital to be found for new and large undertaking. On account of the facilities it affords industrialists can secure big capital through the held up Stock Exchange. Several times the issued capital of a company is under written by well known and leading share-broking firms and this alone goes a long way in inducing the investors to buy shares of the new company and subscribe to its capital. It is now usual to mention in the advertisement when a prospectus is published to mention that application will be made by the Directors to such and such Stock Exchange to quote the share of the company on its official list. The idea is to make the share easily saleable and if it is a good concern to help in its appreciation in value. A Stock Exchange now plays an important part in directing the flow of capital to new industrial enterprises and supplying long term credits without which many industries would not at all come into existence.

*Question 6*—What steps would you take for the restoration of world trade after the war?

*Answer.*—Every country has its arrangements for the organisation of production and distribution within its borders. To make the best use of these arrangements, countries must exchange their products. World trade is not only the device

through which useful goods produced in one country are made available to consumers in another, it is also the means through which the needs of people in one country are translated into orders and therefore into jobs in another. Trade connects employments, productions and consumption and facilitates the three. Its increase means more jobs, more wealth produced, more goods to be enjoyed.

Countries should therefore join in an effort to release trade from the various restrictions which have kept it small. If they succeed in this they will make a major contribution to the welfare of their peoples and to the success of their common efforts in other fields

International trade is kept small by four things :—

- (1) Restrictions imposed by the government ,
- (2) Restrictions imposed by private combines and cartels ;
- (3) Fear of disorder in the markets for certain primary commodities ;
- (4) Irregularity, and the fear of irregularity, in primary commodities.

(1) *Release from Restrictions imposed by Governments.*—Governments have restricted the freedom of traders by many measures and for many reasons. They will continue to do so. No government is ready to embrace "free trade" in any absolute sense. Nevertheless much can usefully be done by international agreement toward reduction of governmental barriers to trade.

(2) In some cases firms have banded together to retain competition by fixing common selling prices, by dividing the world into exclusive markets, curtailing production, by suppressing technology and invention, by excluding their rivals from particular fields and by boycotting outsiders. These practices destroy fair competition and fair trade, damage new businesses and small businesses, and levy an unjust toll upon consumers. Upon occasion, they may be even more destructive of world trade than are restrictions imposed by governments.

(3) After a great war there is danger of violent and rapid movement in the markets for primary commodities. The production of some things has been increased enormously to meet a war demand or to replace sources of production cut

off by enemy action. Some time after the end of the fighting the war demand subsides, goods held by the armies are returned to normal channels, and old resources of production come back into the markets and add to supplies. There is suddenly too much of some commodities and the prices react accordingly. Many countries learned after the last war that such changes can be devastating.

When excess supplies threaten it is necessary to increase consumption. But if such an action cannot be taken rapidly other measures may be adopted. And since action by one country is likely to affect producers and consumers in another there should be consultation between governments.

Consultation may result in a proposal for an inter-governmental commodity agreement. Such agreements are not intended to freeze existing patterns of production but rather to provide a programme of adjustment and a period of time within the essential changes can be made without undue hardship.

During the transition, it may be necessary to restrict production or exports, to fix prices, or to allocate shares of markets among producing countries. Controls of this sort not be applied in any case unless the need is real and serious, affecting many people, and not curable by the normal process of competition. And when they are set up they should be strictly temporary, lasting no longer than required to carry out the necessary shifts. Their purpose is not to protect vested interests, but to prevent widespread distress during the course of necessary change.

(4) the industrial activity of every country is affected by the size and the regularity of its orders from abroad. When industry in any country slows down and its purchases of foreign materials are cut, the effects are felt in every corner of the globe. Full and regular production at home, with increased participation in world trade, is the greatest boon which any people can confer upon producers throughout the world.

It would be necessary to establish general agreement that each country will seek, on its own account, to maintain full and regular production, that it will do so by using measures which would damage other countries or prevent the expansion of world trade, and that all countries will co-operate in exchanging information and participate in consultations with respect to anti-depression policies.

Agreements on this scale clearly require, for their successful operation, both an international forum where they may be discussed and improved and an international staff to assist in their administration.

It is, therefore, suggested that an International Trade Organization be created, to stand beside the existing international agencies dealing with currency, investment, agricultural labour, and civil aviation. It should have a constitution much like those of the other agencies set up by the United Nations with enough internal specialisation to enable it to perform the tasks assigned to it in dealing with trade barriers, restrictive business, practices and international commodity arrangements.

*Question 7.*—On what principles are commercial treaties between any two countries made? Give illustrations.

*Answer.*—See answer to Question No. 9, Economics 1937.

*Question 8.*—What changes would you advocate in the existing policy of protection in India?

*Answer.*—If industrialization is a matter of great importance to the economic progress of India, the question of tariffs as a means of assisting the development of industries requires examination. As far as one can judge at present, it is likely that in the next few years Protection will assume less importance in the economy of the country than it has done in the past. The object of Protection is to help local industries against foreign competition and, therefore, the necessity for maintaining a policy of Protection will depend on how far industries will be exposed to competition from other countries.

It is clear that even though the war is over the abnormal demand for articles of civil consumption, the restriction of imports and the difficulties of shipping and foreign remittance will largely eliminate foreign competition in manufactured goods. It is now certain that these conditions will continue to prevail. But how long they will last is a question to which a definite reply is hardly possible at the present stage. There is, however, one aspect of the post-war situation regarding which it is possible to speak with some assurance. The colossal destruction of material assets which the war has caused will call for a prolonged period of reconstruction on an extensive scale so that the duration as well as the extent of reconstruction required will far exceed what was found necessary after the last war. It is reasonable to anticipate that for a period of approximately five to ten years from now, the demand for

consumable as well as capital goods will outstrip supply and existing industries in all countries will be kept more or less fully occupied. The problem during this period will be how to meet a reviving demand from countries which have been starved of goods with the limited supply available rather than to restrict supplies so as to avoid over-production and uneconomic competition.

During this period of comparative freedom from foreign competition, Indian industries will enjoy a further advantage due to geographical and administrative factors. This advantage arises from the fact that Indian industries have access to a large internal market covering the whole country with no customs barriers between its different parts.

An additional advantage which Indian industries will have in the next few years is that in consequence of the large increase in the prices of agricultural and industrial commodities due to war conditions, the purchasing capacity of India's internal market will have increased considerably as compared with pre-war years. Conditions, therefore, appear to be particularly favourable to a rapid development of industries in India in the near future.

If the foregoing estimate is correct, the assistance which Indian industries will require from the state will be direct assistance in such essential matters as finance for capital requirements, scientific research, transport, education and public health rather than the kind of indirect assistance which protective tariffs afford. Tariff assistance has its uses under certain conditions, but it serves no purpose and may prove worse than useless if the conditions required for efficient and successful operation of industries are lacking. The chief abuse to which protective policy is liable is that the immediate relief which it affords is apt to make both the Government and industrialists oblivious to the fundamental factors which determine the growth of virile and healthy industries. From this point of view it is fortunate that in the years which lie immediately ahead, Indian industries, freed from the fear of uneconomic competition from abroad, will be in a position to direct their attention to the vital question of internal reorganisation. In the accomplishment of this task, the state will necessarily have to play a very important part. But the state will not fulfil its part as it ought to unless it learns to think in larger and more constructive terms of its responsibilities and to quicken the pace of its activities. Protection by tariffs is a matter which even the stalest bureaucracy can handle with

apparent success. But the internal reconstruction necessary for a vigorous, forward-looking policy of industrial development will call for energy and vision such as only a National Government responsible to the people and sensitive to their aspirations can possess.

The conclusion suggested that in the period immediately following the termination of the war, protective tariffs are not likely to apply an important role in our industrial policy. The question still remains what our policy in the long run be as regards protective measures which involves restriction of trade.

What is true of India is true of other countries. The tendencies towards economic, nationalism and self-sufficiency will be intensified in all countries. The trend of the best thought in progressive countries is definitely opposed to a perpetuation of national barriers to the free movement of trade. Bilateralism based on internal equality and reciprocity will take the place of the present policy of the protection. Dr. John Mathai has suggested the following three possible stage in the development of Indian trade policy after the war —

First, during the years immediately following the termination of hostilities, it will not be necessary to adopt a policy involving other than a moderate restriction of imports as regards consumable as well as capital goods. Secondly, while a large-scale industrial plan is under way, its successful prosecution will call for a policy of high tariffs or similar restrictive measures for consumable goods and a policy of low tariffs and generally of free trade in capital goods. Thirdly, when the more essential industries envisaged in the plan have been established, the weight of restrictive measures will be shifted from consumable to capital goods. Since restriction in the case of capital goods, if enforced by means of high import duties, will lay a heavy burden on all industries, other measures of protection will have to be devised for the assistance of Indian industries producing such goods.

*Question 9* — Write short notes on — (a) Price Control (b) Import Control (c) Paper Industry in India

*Answer* — The supply of goods at any time is limited and the possibility of the supply is limited by the available raw materials, labour, force and technical means of production. No country possesses all factors of production in unlimited



quantities. In a war economy government requires a large portion of the total production and when it enters the market was an urgent customer the result must be to send up the prices of all commodities unless the outlays of the other customers are correspondingly diminished and made less urgent. An unchecked initial rise in prices will have a cumulative effect. Prices represent charges to producers as well as to consumers. They influence the cost of production of commodities, and a rise in primary prices might send up the prices of commodities in general. It also tends to set up a demand on the part of wage earners and other recipients of fixed periodic payments towards increasing their remuneration. But an increase of wages leads also to further increase in cost of production and justifies another increase of prices so that unless the movement is checked by the currency authority or by external control there is no means of arresting its progress.

The Government in these circumstances steps in and adopts measures to check rise in prices. Price control, which means the fixation directly of maximum prices by government aims not at preventing prices from rising at all but from rising unduly and checking profiteering. The consumer in general is often ignorant, illiterate and hard-pressed. He becomes an easy prey to the profiteering instinct of unscrupulous dealers. Price control is evidently essential in order that fair prices may be charged and that one section of the community may not profit at the expense of another.

Price control is not an easy matter and unless effective measures are taken to control supply and consumption 'Black Market' make their appearances as has been seen in India.

*Import Control.*—In a war economy is required to make purchases of war materials in other countries. It, therefore, requires currencies of those countries for such purposes. The foreign currencies cannot be dissipated indiscriminately. It, therefore, becomes necessary to regulate imports from other countries by an effective control over them. The primary object of import control is to husband the restricted shipping space and foreign exchange reserves in the best possible manner with a view to maximising war efforts.

Import Trade Control was first introduced in India on the 20th May 1940. Only sixty-eight items were affected; these were selected as being those the consumption of which could be kept within limits without damage to any essential Indian

interest having regard in particular to the extent to which supplies from some countries could be replaced by Indian products, or by goods imported from some countries could be replaced by Indian products, or by goods imported from other countries in respect of which the Foreign Exchange problem was less acute

The items thus brought under control were licensed by Import Trade Controllers established at the four main ports. Licences were issued to importers previously established in any particular trade on the basis of their past imports.

*Paper Industry in India* —India possesses the necessary raw material and commands other favourable conditions for the development of a successful paper industry. Indian paper is made from wood pulp, rags and grass. The grass used is either bhabar or sabai grass. Sabai grass is perennial, and grows in dry climate from Chota Nagpur to Nepta. In recent years, bamboo has been increasingly used as a material for paper making, opening up immense possibilities for the Indian paper industry. There are extensive bamboo plantations in the Southern Presidency, in Kanara, in Bombay and in the forests in Assam and Orissa.

The Bamboo Paper Industry (Protection) Act of 1925 gave protection to writing papers and certain classes of printing papers which were renewed and increased on the recommendation of the Tariff Board Enquiry of 1931. As a consequence, the paper and paper pulp industries have made good progress. The Indian Paper Mills are not able to produce newsprint which has to be imported from abroad to the tune of 45,000 tons per year.

It has been estimated that the utilisation of bamboos for paper making will enable India to produce ten million tons of pulp per annum. The cost of production of paper made from bamboo is lower than the cost of paper made from imported wood pulp. Paper mills are springing up near centres of bamboo production, that is, at Chittagong, Dalmianagar, and Rajamundri. Newsprint or paper for newspapers is made with a high percentage of wood pulp and it is difficult to make wood pulp in India. The paper mills round about Calcutta have to bring their sabai grass from a distance of 500 to 800 miles. But these mills enjoy the advantages of proximity to a market and the presence of coalfields close by. The prospects of utilising electrical energy have led to the starting of the Punjab Paper Mills at Saharanpur.

Even though our paper production has increased, we are still importing substantial quantities of packing and wrapping paper from abroad. The value of these amounted to Rs. 84 lacs in 1937-38 and Rs. 67 lacs in 1938-39. Similarly, paste board, mill board and card board imports were 31,700 tons valued at Rs. 55 lacs in 1937-38, whilst in 1938-39 the imports amounted to 27,050 tons valued at Rs. 45 lakhs. The main item of imports has always been printing paper, which was 61,050 tons valued at Rs. 138 lacs in 1937-38 but declined in 1938-39 to 46,100 tons. The imports of wood pulp used by Indian paper mills were 13,850 tons valued at Rs. 17 lacs in 1938-39. An active forest research policy can easily make us independent of foreign wood pulp supply, in view of our large forests and suitable climate for the growth of the required type of coniferous trees.

The production of paper during the three years, 1936-39 averaged 54,000 tons per year, whereas the imports averaged 75,000 tons per year during the same period. The impetus given by the war has increased the annual production to over 100,000 tons per annum. The recent shortage of coal has affected production in 1944-45 which has been estimated at about 75,000 tons. Our *per capita* consumption of paper is very small in comparison with advanced countries. But with increasing literacy and extension of primary and secondary education, there will be a greater demand for paper. Thus, there is quite a bright future for the paper industry which can cater for an increasing internal market of 389 millions. A properly planned paper industry can make India self-sufficient, regarding her paper requirements.

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## ECONOMICS—PART II.

1944

*Question 1*—Examine the importance of the price mechanism in a money economy.

*Answer*—Price mechanism is of considerable importance in a money economy. One depends upon the other. You cannot separate the general prices from the value of money. When prices are high money purchases less and when prices are low money purchases more of goods in the market. Thus a rise in the value of money is the same thing as a fall in the general level of prices and conversely a fall in the value of money is the same thing as a rise in the general price level.

It is, therefore, very necessary that the value of money should not change too quickly. Money is a yardstick for measuring the value of other commodities. Changes in the value of money or rise and fall in price are brought about by variations in the quantity of money in circulation. The Quantity Theory of money states, other things being equal, every increase in the quantity of money in circulation causes an exactly proportionate increase in the general level of prices. Prof. Fisher Irving has expressed the relationship between the quantity of money and the price level in the form of a formula which he calls the Equation of Exchange. This is expressed as,—

$$P = \frac{MV + M'V'}{T}$$

Where P = Price level

T = Volume of Trade.

M = Metallic Money.

V = Velocity of metallic money.

M' = Credit money.

V' = Velocity of credit money.

Prices of commodities and quantities of money are inter-connected. When the supply of money relative to the demand increases the prices will increase. Inflationary conditions are then said to exist. Inflation causes untold misery to the masses. The agriculturists and manufacturers gain but only at the expense of the consumers. Evidently in a money economy the price mechanism plays no insignificant part.

**Question 2.**—Discuss the relation between the real value of a currency unit and the reserves maintained against it according to law. Illustrate your answer.

**Answer:—**

**Note.**—The currency unit means the convertible legal tender in use as for example the Bank of England note and token optional note (such as the United States Federal Reserve Note) Both can be grouped under the category of convertible common money.

The answer to the question how the relation of convertible common money to Reserve is determined varies somewhat according to whether the country in question does or does not possess any definitive money in use. Before the first European war most Western countries made use of such definitive money in the shape of gold coins and at the present day the United States are still in the same position. In these circumstances, the proportion which convertible legal tender bears to definitive money is influenced by the habits of the people, in the same way as in the proportion which bank money bears to common money in general. There is no doubt that the last war had wrought a great change in popular habits in this respect, so that even where gold coins are available, most people do not show any great anxiety to obtain or use them. In England, Bank of England notes are not at present convertible into gold coins, but most people seem to agree that even if they were to become so there would be no gigantic rush to convert them. The mere assurance of convertibility, it is thought, would have the same kind of soothing effect as the sound of church bells in the distance, and be equally unprovocative of action.

In all countries, however, there is a more obvious influence limiting the volume of convertible common money, namely, the voice of the law. More often, the law sets a limit to the total issue of some kind of convertible legal tender as is the case with the notes of the Reserve Bank of India. More usually it lays down rules about the reserves which must be kept by Governments and banks against the convertible common money which they permit to circulate. We are not concerned with the character of these reserves but as regards the nature of the relation prescribed between the reserves and the convertible common money there have been two main alternative practices. The English practice, dating from the celebrated Bank Act of 1944, has been to limit the "uncovered" or "fiduciary" issue of convertible common money—the excess,

that is, of the total issue over the amount held of the stuff prescribed as reserve. Thus until 1928 the fiduciary issue of the Bank of England was limited by law to an amount which in that year had reached about £20 million, and from 1919 to 1928 the fiduciary issue of the Treasury Notes issued since 1914 by the Government was limited, not indeed by law but by Treasury ordinance, on the same lines. In 1928 provision was made for amalgamating the two issues in the hands of the Bank of England, and the latter's fiduciary issue fixed afresh (though not unalterably) at £260 million.

Elsewhere than in England the alternative method of regulation, which consists in prescribing the minimum proportion of reserves to convertible common money outstanding is almost universal. Thus in America against two kinds of convertible legal tender (gold and silver certificates) a reserve of 100 per cent must be kept against two kinds of token optional money (National Bank notes and Federal Reserve Bank notes) a reserve of 5 per cent, and against the remaining and most important kind (Federal Reserve notes) a reserve of 40 per cent. In European countries, where the note-issue is for the most part now concentrated in the hands of central banks, similar provisions prevail.

It is now evident that the fixed fiduciary system is free from the defect of the proportional reserve system namely, that it resembles the procedure of a certain municipality which tried to guard against a shortage of cabs by ordaining that there should always be at least one cab on the ranks. The Bank of Issue under the fixed fiduciary system would not come into conflict with the law until it had paid out the last penny of its reserves. On the other hand, the proportional system makes it easier than does the fixed fiduciary system to expand the supply of convertible common money. If the former receives an accession of one dollar to its reserves it can expand its note issue by, say, 3 dollars. Whereas if the latter receives an accession of £1 to its reserves it can only expand its note issue by £1.

*Question 3*—Trace briefly the career of the rupee since the end of the last World War to the outbreak of the present World War.

*Answer*—The opening of the first Great War led to general weakening of the currency and exchange position but later on there was an unprecedented rise in the gold price of silver particularly towards the end. Exchange was realised to

1s. 5d. in 1917 and afterwards the Secretary of State announced to vary rates according to the sterling price of silver. Exchange went on rising and the Babington Smith Committee, which intended to stabilise exchanges, recklessly enough through its own recommendation of fixing the rupee at 2s. gold sent up the exchange still further—the highest rate being reached in the first quarter of 1920, viz 2s. 11d. sterling. Later on, under the pressure of a great demand for Reverse Councils the exchange weakened and Government failed to arrest its downward trend. The Government first tried to maintain an official rate higher than the market rate and then finally abandoned their attempt to regulate the exchange. During 1921-25, it followed what has been called the policy of masterly inactivity. In September, 1923, the pre-war ratio of 1s 4d gold was reached and 1s 6d. gold in April, 1925, and it was held there until September, 1931, when it was changed for 1s 6d sterling. In the meanwhile, the Hilton Young Commission whose report was published in August, 1926, had recommended a gold bullion standard without the gold currency and the stabilization of the rupee at 1s 6d gold.

The Currency Act of 1927 provided for the sale and purchase of gold by the Government at Rs 21-3-10 per tola of fine gold and so was sterling to be provided in London after meeting the normal cost of transport from Bombay to that place. Sovereigns and half sovereigns ceased to be legal tender. A gold bullion cum sterling exchange standard was thus established in India. But on 20th September, 1931, Britain went off the gold standard and in spite of severe criticism in the country, the rupee was linked to the sterling at the rate of 1s 6d and it shared the fluctuations of the latter which when managed were in Britain's own interest. The gold bullion standard was substituted overnight with a fortuitous sterling exchange standard. Gold prices went up and gold began to flow out of the country for the first time in its history. The total amount of gold exported outside India from September, 1931, to the end of June, 1940, valued Rs 351.40 crores. It was good that this gold came out of the hoards but it was bad that it was not retained by the Reserve Bank of India. Had it been retained, we would have not been obliged to purchase the same gold now from our former purchases at double the price at which we sold it then. The constitution of Reserve Bank in 1934 maintained the *status quo* with regard to exchange. The Bank is under an obligation to sell and purchase sterling at the rate of 1s 6d so that it cannot now fall below 1s. 5½d or rise above 1s 6¾d. The Victoria coins had by this time suffered considerable wear and tear and hence, though these continued to be full-legal tender, their withdrawal was accelerated. With this very object in view restrictions on the acceptance

of Victoria rupees were further relaxed in 1938-39 to encourage the public to return these coins.

*Question 4* — Discuss the function of the Central Bank of a country to maintain the value of its currency unit.

*Answer* — The control or adjustment of credit is accepted by most economists and bankers as the main function of a Central Bank. This function enables the Central Bank to regulate the currency and maintain the value of the currency unit. Through its policy of expansion and contraction of currency the Central Bank controls the stability of the currency unit both within and without the country. The principal methods used for the control of currency are —

(1) *The Bank rate policy* : *e.* the lowering or raising of their discount and interest rates with a view to lowering or raising money rates generally and encouraging the expansions or contraction of currency. When the Central Bank feels the necessity of expansion it lowers the bank rate and thus encourages rediscounting. Commercial banks transfer their bills in their bill portfolios to the Central Bank and obtain notes. If it feels the necessity of checking expansion it raises its rate of discount. The theory underlying the use of the discount rate as the principal instrument of credit control under the gold standard was, that changes in the discount rate of the Central Bank would bring about more or less corresponding changes in local money rates generally and that such changes in money rates would, through their operation on the supply of and demand for money and credit have the effect readjusting the internal levels of prices and the value of the currency unit. For its successful working the theory underlying discount rate policy requires, firstly, that the discount rate of the Central Bank should have a prompt and decisive influence on money rates and credit conditions within its area of operation, and, secondly, that there should be a substantial measure of elasticity in the economic structure in order that prices, wages, rents, production and trade might respond to changes in money rates and credit conditions.

(2) *Open Market Operations* — Open market operations are held to cover the purchase or sale by the Central Bank in the market of Government securities and foreign exchange. The theory of open market operation is that purchases or sales of securities by the Central Bank tend directly and immediately to increase or decrease the quantity of money in circulation and the cash reserves of the commercial banks. As



increase or decrease in the supply of bank cash and therefore in the credit creating capacity of the Commercial Banks tends still further to increase the quantity of money and the changes in the quantity of money tend to having about relative changes in money rates and credit conditions which in turn bring about changes in the value of the currency and domestic levels of prices. Open market operation thus constitute another method of aiming at the desired expansion or contraction of money and credit.

As a central bank of the country the Reserve Bank is also entrusted with the duty of maintaining the stability of the external value of the rupees and for this purpose it is required to sell and buy sterling within certain rates fixed by the Act. Under section 40, the Bank is obliged to sell, to any person who makes a demand in that behalf and pays the purchase price in legal tender currency, sterling for immediate delivery in London at a rate not below 1s 5-49/64d for a rupee. No person, however, is entitled to buy an amount of sterling less than ten thousand pounds. The Bank is similarly obliged to buy sterling at a rate not higher than 1s 6-3/16d for a rupee. This keeps to maintain the external value of the rupee.

**Question 5.**—Would you advocate the methods of inflation to finance a plan for the economic development of India? Give reasons.

**Answer** —Criticizing the desirability of financing the plan for the economic development of India by inflation or created money suggested by the joint authors of the Bombay Plan Messrs Wadia and Merchant observe.

"The plan partly relies on "created money" for its successful working. Now so long as there are undeveloped resources to be utilised there is no reason to fear the expansion of currency and credit which "created money" involves. But the problem of creating more money is not so simple as the Planners seem to think. All their calculations are based on 1931-39 prices, and as they do not want deflation, they seem to have ignored the reaction of huge amounts of additional money on the already high price structure. The Planners suggest that "the objectives to be kept in view in controlling consumption will be to enforce fair selling prices..... and to prevent inflation". They also refer to control of new capital issues and control of trade and exchange, and they naively believe that this can be accomplished without nationalising the banking structure."

"Created money in a capitalist economy is doubly dangerous, even with the proposed controls. The fundamental principle to be kept in mind in the use of this method of finance is that the burden of costs should be so distributed that the broadest backs can bear the greatest burden. This implies rigid control of profits and prices, and the total suppression of black markets and hoarding. Experience has already made us wary about the exercise of controls by a government which is in essence the representative of big business. Millionaires caught for breaches of control orders may be let off with fines which are relatively immaterial in view of the big profits which a breach of orders bring to them, whilst petty shop-keepers may be punished with fines which they are unable to pay for trifling failure of conformity to the requirements of the law. Created money may stimulate production, but there will be a period of transition between the issue of more money and the availability of goods, when the poorer classes will suffer acutely. In other words, created money, during the transition period at least, would be tantamount to 'forced savings' so far as the masses are concerned, with their low standard of living. The mere existence of idle resources cannot save the masses from the stress and strain of inflation in a society. Our Planners do not suggest any subsidies to consumers, though they would unhesitatingly support the giving of subsidies to producers in periods of hardship. The hardships on the poorer classes will be all the greater, during the transition period, when we take account of the possibilities of credit expansion through banks controlled by private enterprise supplementing of expansion of currency. Capitalists may sing in jubilant notes of the prosperity which created money would bring. How can we expect them to be alive to the blood and tears which created money may bring, for however short or long a period, to the millions with limited incomes? And even granting the necessity of created money for increasing production, it can only be justified if the scheme of distribution is definitely biased in favour of the masses who are likely to suffer for this created money."

*Question 6* —What changes do you foresee in the foreign trade of India after the War?

*Answer.*—The war has altered the position of India in one fundamental aspect. In the course of a few years she has changed from a debtor to a creditor country, with the result that her effective demand for overseas goods has considerably increased. If she husband her resources carefully,

she will not have to suffer helplessly adverse changes in the terms of trade. Secondly, as a creditor nation, and as a country with an export surplus in a wide range of raw materials and with prospects of developing an export trade in manufactured articles as well, it is clearly to India's interest that the trade of the world should, as far as possible, be multilateral. A world, in which trade is largely bilaterally organised, would cramp her development and the economic progress of world at large. This does not mean that we must give unqualified support to free trade. Not only tariffs for the purpose of protecting our own industries, but also special arrangements with certain foreign countries which are in a position to help us will doubtless be necessary.

Whatever the United Kingdom and the United States feel it would not be possible for a relatively backward country like India to sacrifice tariff autonomy in the interests of so-called "international corporation".

India will have also to develop for meeting the cost of her essential imports of capital goods. This will be necessary because, on the one hand, our sterling balances are not likely to be repaid all at a time, and, on the other, our demand for imported materials in order to implement a plan will considerably increase. It is difficult to hazard any definite opinion about the post-war prospects of our export trade. Japan and Germany may after the war prove to be worse customers than before. Although there may be scope for some expansion of trade with the U.S.A. it should be remembered that the trade of the two countries, U.S.A. and India, is in some respects competitive, as for instance in cotton. The possibilities of developing export trade to countries in the Middle East and around the Indian Ocean are, however, more promising. It should be possible for India to retain and develop some of these markets gained during the war. But even when allowance has been made for such expansion, it should be borne in mind that in the period before the war, 54% of Indian trade was with Empire countries. This means that the Empire countries were our best customers, before the War, and if this position remains substantially unaltered even after the War, it may be necessary with a view to develop our markets in these countries to accord to them some favourable treatment.

Though India may have need to ally herself closely with one or two industrial countries with a view to secure adequate help in her industrialisation and may have for

this purpose to give them special treatment in certain matters, her main interest lies in the emergence of an expanding trade among all nations. Whether the post-war years will witness such emergence or not is more than any one can say at present. But if trade is not to be developed only along certain pre-determined lines then we have to keep our ideas of world trade in a somewhat fluid state. Our position as a creditor country, the trade relations which we have developed during these war years with the Middle East and the countries adjacent to us, our dependence on countries like the U. S. A. and Britain for the equipment of industry and the scope which the re-entry of Soviet Russia into world trade will create for us and for others—all these are factors which we shall have fully to take into account before we seek to give shape to our foreign trade relations.

*Question, 7*—Discuss the advantages and disadvantages of industrial combinations, with reference to the Cement Industry in India.

*Answer*—One important feature of the modern organisations is the consolidation and integration of industry. Combinations of all kinds are the order of the day and may be regarded as a new development of large scale production. The object underlying such combination is to secure better results by joint action and further economies of large scale production than before the combination. The idea is to eliminate competition and unnecessary waste. The modern improvements in transport and means of communication have favoured their growth and development. The cut-throat competition among rival firms and the difficulty to procure capital at moderate rates has forced the producers to join hands with each other.

Combinations are thus formed for the purpose of—

- (i) buying raw materials cheaply,
- (ii) selling products to their customers at high rates;
- (iii) Obtaining general economies resulting from large scale organisation and from co-ordination of efforts by eliminating competition. Combinations are formed with the object of benefiting the producers and the interests of the consumers are seldom at their heart. They may be on the other hand, harmful to the public since they possess the following drawbacks.

(1) The often resort to cut-throat devices of competition against small independent producers. They may sell for a time under cost of production until the rival has been forced are to give way, differentiate the price of the same product according to the capacity of their consumers, allow secret rebates to influential consumers.

(2) They often result in the formation of monopolistic organisation which are harmful to the consumers.

(3) They lead to speculation in stocks and over-capitalisation.

(4) They restrict enterprise. The elimination of competition kills the desire of enterprise. These are also the drawbacks of monopolies.

(5) They result in unemployment and displacement of labour caused through the closing of some concerns and the policy of restricting output.

It was in the year 1936 that the Indian Cement Industry took a great step forward with the formation of an effective combine known as the the associated Cement Companies of India. This striking merger of ten principal cement producing concerns has improved the technical and commercial organisation of the industry. Internal competition was done away with and since then the merger company has been earning huge profits.

*Question 8.*—Distinguish between consumer's goods industries and capital goods industries. What is the relative position of each of these in India ? Give reasons and suggest improvements.

*Answer.*—Industries may be brought under one or the other of the two categories—producers goods and consumers goods. Consumers goods industries are concerned with the production of goods required for consumption while producers goods industries manufacture goods essential for turning out consumer goods. Among the producer goods, the following may be mentioned :—

1. Power-electricity from coal and water.
2. Mining and metallurgy.
3. Engineering industries including machinery of all kinds, machine tool and spare parts.

4. Chemicals including fertilisers and plastics.
5. Automobiles.
6. Locomotives and wagons
7. Ship-building.
8. Defence industry.
9. Cement.

Among the consumer goods industries the following are to be noted :—

1. Rice and flour milling industry
2. Oil crushing industry.
3. Cane-crushing and gur making.
4. Sugar industry.
5. Tobacco curing and cigar and cigarette manufacturing.
6. Dairy industry, including manufacture of dried milk products, preparation of butter and ghee.
7. Dehydration industry.
8. Fruit canning.
9. Potteries.
10. Derived chemical industries like glass, paint and varnish, soap.
11. Match industry.
12. Paper.
13. Textile and clothing.
14. Leather and footwear industry.
15. Drugs and Pharmaceuticals.
16. Electric goods.

The producers goods industries, with the exception of one or two like cement, occupy an important position in the economy of India. The last war gave an opportunity to develop the producers goods industries but the short-sighted policy pursued by the Government prevented their development. Instead of regarding the establishment of the heavy industries in India as a long war interest and facilitating the obtaining of machinery for this purpose from abroad,

they persisted in their attitude of half-hearted sympathy, if not one of the active indifference. The history of the proposal to establish an automobile industry in this country and its reception at the hands of the Government of India is well known. The manufacture of locomotives in India was relegated to the post-war period while neither a ship-building nor an aeroplane industry had been brought into existence in the country. To-day, it cannot be said that the Indian Government has taken such advantage of the industrial opportunities offered by this war as the other British Empire countries have done. and the effect of this war has not been to make such fundamental additions to Indian industrial capacity as was the case during the last war.

The war has, however, benefited our consumers' goods industries and India is now not dependent for several commodities upon foreign countries. India's principal industries, Textile, Jute, Tea, Cement, Sugar etc. have experienced a tremendous boom due to increased war orders and lack of foreign competition. Of the new or undeveloped industries that have received the greatest encouragement the chemical industry, leather industry and paper industry are the most important. Our industries are mainly the boons of wars. The American Civil War gave us the cotton textile industry, the Crimean War, the jute industry, and the Great War, the iron and the steel industry. The present War has given us only small industries thus far.

The question which has been agitating the minds of the industrialists since the end of the war is whether consumers goods industries or producers goods industries should receive priority or whether a simultaneous development of all these industries is possible. The Bombay plan suggests the immediate establishment of the basic industry in preference to any other industry. Its rationale lies in the fact that without the key and basic industries any considerable addition to the capacity of consumer goods industries or their output would be unthinkable. To a certain extent this is correct. But our resources are not so large as to enable us to start industries for capital goods in the initial stages of our economic development. Mr. N. R. Sarkar holds the view that India should concentrate on the importation of machinery for the production not of capital goods but of consumer goods. In his opinion there are certain, definite advantages in putting an emphasis on the development of consumer goods industries in the initial stage. In the first place, the scope for immediate

employment is greater than that arising from the development of capital goods industries. Secondly, the growth of consumer goods industries has a very direct bearing on the rise of the standard of living and the urgency of a rise in the standard is, of course, very patent. If the initial emphasis is not placed on consumer goods industry but on capital goods industry, it follows that in the initial stages the demand for consumer goods would have to be met by imports.

He further adds — "If India had the requisite supply of capital and technical personnel, the development of capital goods industries might have proceeded simultaneously, but since that is not so and since we have reason to think that in view of the privation of the war period, the public will not be in a mood to make too large a sacrifice of present comforts for the sake of the future, I think preference has to be given to consumer goods industries."

*Question 9.*—Write short notes on — (a) Anti-Inflation measures (b) General Price level (c) International cartels, (d) Multilateral trade

*Answer* (a) *Anti-Inflationary Measures* — Inflation means the rise in prices caused by currency expansion. As Inflation causes hardship to the masses several measures are employed to curb it if the note issue cannot be stopped. The Government employed the methods to control inflation —

(a) *Increased taxation.*—Both direct and indirect taxes have been increased to unprecedented levels. E P T is collected in advance. Forced saving has been introduced with regard to a considerable percentage of the untaxed portion of the Excess Profits. There is also an advance collection of Income-tax.

(b) *Elaborate loan programme.*—Attempts are made to attract all sorts of investors. Small interests are attracted by National Savings Certificates, Prize Bonds, etc. Government officers take an active part in inducing people to subscribe to Government loans.

(c) *Restraint on forward trading.*—Forward speculation in certain lines, e.g., cotton, has been forbidden. Restraints have also been imposed on speculation in general.

(d) *Sale of gold, silver consumers' goods.*—In order to absorb the surplus purchasing power, the Government is also trying to sell gold and silver to the public by importing them.



from outside. Imports of consumers' goods have also been stimulated with the same end in view.

(e) *Price-ceilings* have also been introduced with regard to a variety of goods including foodstuffs.

(f) Rationing has also been introduced in the big towns and cities, restricting consumption of foodstuffs, which helps to release purchasing power for the purpose of subscription to Government loans.

As a result of all these measures, price-level has declined somewhat, although the volume of note circulation has been increasing steadily

(b) *General Level of price*.—It refers not to the price of one commodity but to the prices of several commodities during a particular time. If the price of wheat falls at any particular time the prices of all other commodities remain unaffected the general level of prices remains unaltered. Changes in the general level of prices are brought by changes in the quantity of money. When the quantity of money increases the general prices rise and when the quantity of money decreases the general prices fall. The general level of prices rise or falls in inverse proportion to the value of money and in direct ratio to the quantity of money. The variations in the general level of prices are measured by constructing index number for wholesale prices.

(c) *International Cartels*.—A cartel is essentially a selling agency acting on behalf of the constituent manufacturing firms. It is a legal entity, distinct and separate from the members, and it undertakes the marketing function which would otherwise require to be performed by the latter. The cartel purchases the products of the manufacturers and sells them on the markets of the world. The individual producers are paid prices varying with the quality of the product, but bearing an agreed relation to a standard or base price fixed for the standard quality. The cartel in turn, charges what the market will bear, and may charge different prices in different zones. When the market cannot absorb all that the members are able to supply, the orders are rationed among the latter in the ratio of their producing capacities. The members in turn may make private or independent arrangements for redistribution among themselves, thus one firm may purchase from another the latter's quota of orders. It will be observed that the cartel does not interfere with the

internal management of the individual mine-owner or manufacturer. The latter so far retains his individuality. But he unloads all marketing functions and risks upon the cartel, which usually enjoys a partial or complete monopoly

An international cartel embraces more than one country. For example, the Chadbourne Agreement to restrict sugar production, negotiated in 1931, covered production in Germany, Belgium, Hungary, Poland, Czechoslovakia, Yugoslavia, Cuba, Mexico, Peru and Java. This area produced nearly half the world's sugar in 1929-30 but in 1934-35 it produced less than 30 per cent of the total output. The Agreement expired in 1935 and was not renewed. In the same way the Rubber Restriction Scheme led to a great growth of production in the Netherlands, East Indies, which were outside the Scheme, and this compelled the Scheme to be abandoned in 1928. The New Agreement of 1934 includes the Netherlands East Indies and nearly all other important producing areas.

(d) *Multilateral Trade*—This term symbolises the realisation on the part of the leading nations that co-operation between nations in political relationship is inadequate to ensure world peace and an effective measure of international regulation of commerce should be an essential part of the basis for a new world order. The object underlying multilateral trade agreements is to foster trade relations between the members who agree to incur certain obligations. The members are to undertake (1) to accord to imports from other members treatment no less favourable than accorded to domestic products, regarding internal taxation and regulation of trade, (2) to provide for products in transit from one to other members freedom, from customs and transit duties, from unreasonable changes from discriminatory treatment, (3) to simplify customs formalities and thus to eliminate indirect protection and so on.

The object of these regulations is to conduct trade on healthy and uncompetitive lines and to eliminate competition and more particularly to control exchange position between the member nations.

## ECONOMICS—PART II

1945

*Question 1.*—Discuss the position of gold in the monetary system of the world.

*Answer*—The future of gold in monetary system has been a baffling problem. During the last war gold played an insignificant part in settling international debts. Credit was granted on extensive scale. The lease and lend agreements by the belligerent allies with the U.S.A. did away with the use of gold. Gold was mal-distributed in the pre-war period and the pre-war picture of the position and gold remained unaltered during the war. That picture was one of America experiencing increasing influx of gold. During the first few years of the War this one way traffic continued in a metal which is meant to be distributed all over the world and to keep shifting from place to place so as to keep the equilibrium of trade among the nations.

The movement for obviating the need for gold is not likely to die with the war and will continue in times of peace. For this movement is far older than the War. Dating from the Geneva conference and the appeal for minimising the monetary use of gold it has progressed slowly and surely. First England had gold exchange standard, then the lower reserve ratios and later a fluid ratio. The depression forced on the majority of nations not only the system of exchange controls but also the system of quotas, bilateral trade pacts and international barter. The growth of totalitarian tendencies has relieved government of the fear of loss of confidence in the currency. Though we are assuredly a long way from the dethronement of gold, gold is no longer the absolute monarch of national or world economy. Lack of gold has lost its terrors for the majority of nations and failure to achieve better distribution of gold might well seal its fate as a monetary metal.

This is one view. Gold has, however, a definite place in the monetary places formulated by the United Nations Organisation. The international currency unit will be exchanged for gold. Discussing the future of gold in its issue of November 1492 the London Economist wrote.—

"In any case the decision to use or abandon gold in the post-war monetary mechanism is one that will not be taken without reference to the immense vested interests affected

However unfortunate such admission may be, it will be political as well as an economic decision. These vested interests can very briefly be defined, the United States holds four-fifths of the world's stocks of gold, the British Empire controls three-fifths of its current production. It would be strange indeed if gold were found to occupy no place in the post-war currency system."

*Quest on 2.*—Examine the advantages and disadvantages of Exchange Control in War and Peace.

*Answer* —The term Exchange Control is much more often used than clearly defined. It is used as a synonym for exchange restrictions. Dr Enzig means by Exchange Control all kinds of State intervention in commodity and capital movements to influence foreign exchange rates while another Economist limits the definition to measures intended directly to restrict the supply and demand for foreign exchange and in his definition includes even those measures which bring under control all foreign trade or financial movements. The measures fall under two groups (1) Direct measures which affect the foreign exchange market such as (a) intervention in foreign exchange operations, (b) restrictions on capital movements, speculation, foreign debt payments, on purchases and holdings of foreign currencies, etc., (c) Central Bank's gold policy which affects the gold points and thereby the exchange rates, and (d) "Exchange clearing" which obviates the necessity of foreign exchange markets.

(2) Indirect measures which exercise their influence on Foreign Exchange through the intermediary of their effects on some other factors like exports, imports and capital movements. These include import restriction such as tariffs, quotas and prohibitions, (b) export bounties, (c) barter agreements which create new market for export and (b) embargo on foreign loans. The devaluation of currency and institution of exchange equalisation funds have much the same influence as Exchange Control. Exchange Control may, therefore, be defined as a system of State intervention interfering directly or indirectly with the tendencies which influence exchange rates.

Exchange Control regulations vary in different countries to suit particular conditions but the principal on which they are based are practically the same even if the reasons why exchange control has been adopted, are not. The history of Exchange Control is not a new one. In 1932.

several countries had introduced [full-fledged Exchange Control comprising measures of the type mentioned just above. Some like Portugal and Austria also devalued their currency, while a few like England (1932) and the United States (1934) instituted exchange equalisation funds both these measures having their effect similar to Exchange Control. The network of restriction thus spread so rapidly and indiscriminately that between 1931 and 1935 there was hardly any country with an independent currency policy which did not adopt one or the other type of Exchange Control. Exchange Control is not a new thing in India also. Exchange Control has been exercised for many years in the form of buying and selling of sterling by the Government of India and later by the Reserve Bank of India in order to prevent sterling-rupee rate from going beyond the lower and upper statutory rate. There did not exist any restriction on remittances abroad as the Reserve Bank of India possessed sufficient resources which could enable it to discharge its obligations as the controller of rupee-sterling exchange without its having resort to any system of restriction on sterling exchange operations.

Exchange Control during peace time helped the countries whose currencies were not based on gold to maintain the external value of their currency unit by artificial methods.

The object of Exchange control during war is to conserve gold resources, prevent export of capital from the country and to check speculation in Exchange which is generally encouraged by war conditions. But measures of Exchange control restrict free exports and imports of commodities from and to a country and cause dissatisfaction among the business community and while they are inevitable during a war they produce a certain degree of adverse reaction on commodity prices.

**Question 3.**—Give a brief account of the fluctuations in the value of the rupee during the inter-war period.

**Answer.**—See answer to Question No. 3, Economics, 1944.

**Question 4.**—Discuss the need of regulation of banking in India.

**Answer.**—The need for regulation of banking in India has been long felt for many reasons. The main reason is the widespread banking failures in the country arising out of mismanagement due to inexperience, over trading, low cash

reserves, investment in less liquid securities and in some cases no investment at all, unsecured loans to officers and directors offering of unbusinesslike rates to attract deposits, general instability of economic condition, and the lack of a strong bank with a unified and central control. The last defect has been done away with by the establishment of the Reserve Bank of India. But the establishment of the Reserve Bank has in no way smoothened the path of the Indian bankers. The point is crystal clear from the fact that out of a total failure of 951 banks from 1913 to 1941, 509 i.e. about 60% of the total failure took place in the regime of the Reserve Bank and at a time when there was nothing like a banking crisis. Only recently the Finance Member in the course of his speech while moving the Bill restricting opening of branches by banks informed the Legislative Assembly that a particular bank with a paid-up capital of Rs. 30,000/- had over thirty-five branches in different parts of the country.

The Banking Legislation should be designed to place Indian Banking on a sound footing and create closely in integrated money market. Such a legislation would safeguard the interest of the depositors and seek to achieve greater co-ordination between Central Bank and banking companies. The Banking Companies Law should go a long way to place the credit structure of the country on sure and stable foundations.

To ensure sound banking it is necessary that the banks should be prohibited by statutory act from granting loans and advances without adequate security to the directors and to all those firms and private enterprises in which they are financially interested. One of the common cause of banks failures in the past, as has been stated above, has been the grant of unsecured loans to industrial and commercial concerns in which the directors were keenly interested. The directors of a bank in securing such loans may be acting in good faith. The enterprises in which they are engaged may be very sound in themselves. But if these enterprises for certain reasons turn out to be less profitable than expected by their promoters, the banking is bound to run into difficulties. It is necessary, therefore, to prohibit unsecured accommodation to the directors altogether.

The control over credit facilities by the Central Bank is essential for the maintenance of a fair and stable price level. Restriction of credit accommodation to only genuinely productive enterprises and discouragement of credit facilities

for speculative purpose are vital to the policy of counteracting inflation. The legislation should, therefore, give power to the Reserve Bank to give directions to the banking companies in the policy of granting credit facilities. The Reserve Bank should also be vested with power to issue instructions to the banking companies in regard to those practices which are likely to effect the interest of the depositors and also to cause harm to the shareholders.

*Question 6.*—Discuss the position of large-scale industries in India in the economy of the country. What steps would you take to improve the same?

*Answer.*—Indian industries may be divided into two classes —

(1) industries carried on with hand operated appliances in the home of the worker which are cottage industries, and

(2) organised industries with power operated machinery carried on in workshops of factories

In recent classifications of Indian industries the organized industries are further subdivided into two categories small-scale industries and large-scale industries. For instance, the Bombay Industrial and Economic Survey Committee observe "By small-scale industries we understand industries where power is used and where the number of workers does not exceed 50 and the capital invested is less than Rs 30,000," *e.g.*, motor-repairing, oil-pressing, hosiery, watch-manufacture, soap-making, rice and flour mills, etc. Large-scale industries are those where power is used, and the number employed exceeds 50 and the capital invested is above Rs 30,000, *e.g.*, cotton mills, sugar factories, paper mills, etc. The National Planning Committee also divided Indian industries into three classes cottage industries, small-scale (or medium-sized) industries, and large-scale industries.

Though India is predominantly an agricultural country it has been steadily developing its large scale industries. The principal organised industries in India are Textile, Iron and Steel, Jute, Sugar, Cement, Paper, Coal, Leather, Match-making, Chemical and Engineering.

The last war has given a stimulus to the development of our large-scale industries, which were soon absorbed in the prosecution of war orders. Owing to the curtailment of imports of steel from the U. S. A. (owing to the necessity for

conserving dollar exchange) and the U. K., the Indian iron and steel industry had not only to expand its production of steel, but also to manufacture a large variety of special steels suitable for munitions production. Notable among the latter are a special bar for the manufacture of shells, a bullet proof armour plate, gun turrets, high steel machine tools and stainless steel for surgical instruments. The Indian Jute Mills industry and the cotton mill industry were similarly inundated with war orders which have brought about an era of unprecedented prosperity for them. Tea, cement, sugar, coal, paper, glass and other established industries also experienced a tremendous boom due to increased war orders and foreign competition.

India is now self sufficient in regard to several articles like pig iron, sugar, etc. But in spite of all these developments, as has been aptly remarked by the Fiscal Commission, "the development has not been commensurate with the size of the country, its population and its natural resource." The industries mainly rely on the foreigners for the supply of accessories, stores and machinery. Until recently foreign capital financed almost all the important industries of India, but in recent years the use of indigenous capital has increased.

The Government of India, apparently under orders, from H. M. G. have favoured a relatively slow and halting policy of industrialisation for India in the interests of Britain's post-war export trade with India. Even the exigencies of a total war failed to liberalise the government's determined policy. The same hostile attitude is being manifested in the numerous official statements regarding post-war reconstruction in India. Indian manufactures wanted to develop ship-building, the manufacture of aeroplanes, heavy chemicals and other key industries. The government turned a deaf ear to their requests. Anxiety for British-vested interests in India is thus the main stumbling block now as in the past.

We have ample raw materials and adequate supplies of labour, the war has given a powerful stimulus to the development of industries. If in spite of the favourable environment created by the war, and in spite of all the advantages we enjoy, we still lag in large scale industrial enterprise, we might well be excused if we look for the causes of our economic and industrial backwardness in the lack of power to control our own economic destinies.



In India the war has served as a kind of protection to industries by eliminating competition from countries directly engaged in the prosecution of the war. As a result, many industries have been established in the country which but for war-time conditions would not have been established so soon. Foreign competition would appear again with the cessation of hostilities when the countries, now engaged in war, would switch over to normal, peace-time economy. Industries established during the war may, therefore, be faced with fierce foreign competition held in check for a time during the war, and many of them would most certainly go down in absence of some kind of protective measures. It will have to be decided therefore, which of these war-time industries require protection. Protection may also be needed for new industries set up after the war, whether consumption goods industries or defence and key industries.

It will be necessary to provide a suitable system of industrial finance to meet the requirements of the industries.

It has been recognised that the development of India's economic resources depends largely upon her ability to adopt, and apply the results of scientific and technological research in all fields of activity. It will be, therefore, necessary to establish Scientific and Industrial Research Institute to guide the industries.

The manufacture of machine and mill store should be undertaken in India if India is to develop her large scale industries.

*Question 7* — Distinguish between bilateral trade and multilateral trade. Which would you prefer and why?

*Answer* — The bilateral trade agreements are made between two trading countries who agree to adjust their exports and imports in such a way that an exact balance is created and thus the necessity of devising means of payment is obviated. It is still customary to insist the most favoured clause in such bilateral agreements but the operation of the clause is rendered nugatory by the simultaneous inclusion of provisions relating to financial and quota arrangements, industrial undertakings and regional preferences etc.

When the principle is extended to several countries the trade becomes multilateral.

The last war meant cessation of the trade with the continent and later on with Japan, Burma and the other occupied countries. The relative share of the Empire countries in the imports has increased though that of the United Kingdom has continued to decline as previously U S A has gained most. Imports however increased from countries surrounding the Indian ocean particularly Egypt and the Middle East countries. Iran got as large a slice as 16 per cent of the value of the total imports in 1942-43. The relative share of the United Kingdom in the exports from the country declined but that of the Empire as a whole increased to more than 67 per cent. The increase has been particularly marked in the case of Ceylon, Australia, and South Africa. The importance of non-Empire countries in our export trade declined still further having been reduced to less than one-third. U. S. A.'s relative share during the war period has become increasingly important and so have exports to countries of the Middle East like Turkey, Syria, Arabia and Iran experienced substantial improvements.

These war tendencies, if they indicate any trends, disclose the growing importance of the Empire both in our exports and imports but with a deterioration in the position of the United Kingdom itself. They reveal still further that there has been a comparative decline of long distance traffic and the concentration of our trade with countries bordering the Indian Ocean and the Middle East. During the post-war period while the country may look forward to the increased imports of producers' goods mainly from United Kingdom and the U S A, it cannot hope to find markets in these countries for its own manufactured articles except high class luxury and artistic consumer's goods. These countries shall, of course, require some of our raw materials such as mica and manganese. England may continue to take some of our cotton. But we will have to find our export markets nearer at home in the less industrially advanced countries of Asia, which may eventually also supply us raw materials that we may need. In the post-war period therefore the country's entry into a scheme of Empire trade may prove restrictive for our best interests lie in multilateral trade.

As a creditor nation and as a country with an export surplus in a wide range of raw materials and with prospects of developing an export trade in manufactured articles as well, it is clearly to India's interest that the trade of the world should, as far as possible, be multilateral. A world, in which

trade is largely bilaterally organised, would cramp her development and the economic progress of the world at large. This does not mean that we must give unqualified support to free trade. Not only tariffs for the purpose of protecting our own industries, but also special arrangements with certain foreign countries which are in a position to help us will doubtless be necessary.

*Question 8.*—What in your opinion should be the exchange value of the rupee after the war? Give reasons

*Answer*—In the past, the need of foreign exchanges was allowed to determine the internal value of the rupee. In fixing the external value of the rupee, due attention was not paid to the effects of this step on internal prices and production. The exchange value of the rupee was usually fixed too high. Rupee prices were brought down as a result and production suffered. With increased insight in monetary theory, the supreme need of paying first consideration to the internal needs of the country has become apparent, so that the first question that we have to decide in determining the external value of the rupee after the war is the desirable post-war price level in India. It is certain that while prices in India after the war should not be so high as now, any idea of allowing them to fall back to their pre-war level or anywhere near it is out of the question. As to the exact price-level that should be allowed to prevail after the war so as to reduce the injustice to the middle classes, creditors and unorganized workers to the minimum without any adverse effects on production there is no agreement still. A decision can only be arrived at after a detailed inquiry. It may, however, be laid down that the price level will have to be somewhere between 150 and 200 to achieve these ends.

The question of the exchange value of the rupee depends, in addition to the post-war internal price level, on the prices in other countries after the war. These prices have risen in different proportions in different countries. In England and the United States of America they have increased by only about 150 per cent whereas in the Middle East the rise has been greater even than in the case of India. What may be the correct ratio from the viewpoint of trade relations with the first group of countries will not be correct from that of trading with the others. Taking the need of our export-import relation with the more advanced countries as greater it is probable that a lower ratio than at present would be

called for. It is not, however, possible to give any final opinion on this matter, much less guess the extent of exchange depreciation called for, unless we have an idea of the prices likely to prevail in these countries after the war. There are many factors to be taken into account, and it is very difficult to evaluate the strength of each at this moment. Above all, we have the unpredictable Government policy and its consequences to contend with. It is, therefore, better to watch the post-war price trends in different countries, and decide on any permanent ratio only after affairs have settled down. Any conclusion at this stage would be premature. Naturally, the best body to do this work of watching, and to determine when the time has come for deciding our exchange ratio will be the Reserve Bank of India.

For a long time past in some way or another, the rupee has been linked to sterling. Any change in the external value of sterling has automatically produced changes in the external value of the rupee regarding countries other than the sterling bloc. The changes in the value of sterling are decided by the British Government in the interest of Britain. This has had undesirable consequences, as Indian needs do not always coincide with Britain's. In the future it is essential that this sterling link should be snapped. This, however, would not rule out any arrangements on the Anglo-French-American lines of a semi-permanent nature to have the advantages of a stable exchange, or our joining the International Monetary Fund with adequate safeguards. No long-range commitments should be entered into, and the rupee should be free to go its own way unhampered by the needs of sterling.

**Question 9** — Write short notes on — (a) The International Monetary Fund (b) Black Markets. (c) Deflation

**Answer** — (a) *The International Monetary Fund* — An international monetary conference was held at Bretton Woods (U.S.A.) in July 1944. The main object of the conference was to establish healthy international trade and investment among the participating nations. The conference recommended two new international monetary organisations — (1) The International Monetary Fund and (2) The International Bank for Reconstruction and Development.

The purposes of the Fund are to facilitate the expansion and balanced growth of international trade thereby leading to the development of productive resources of all members.

to maintain orderly exchange arrangements among members, to assist in the establishment of a multilateral system of payments in respect of current transactions and to make available to members the resources of the Fund under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures detrimental to national or international prosperity and progress. The fund is not a clearing scheme for all international monetary transactions, nor is it intended to be used for large capital movements. It seeks to provide normal short-term credit facilities on current trade account.

*Black Market.*—Price control is not an easy matter where Government cannot effectively control the supply and the demand. The result is that "black markets" appear. A black market means buying and selling a commodity at unauthorised prices or at prices above those fixed by the Government. The black market is not a particular place, as the name implies, with a sign board prominently displayed. But it exists everywhere and in almost every commodity whose price is controlled. We see that black markets are common in India in cloth, sugar, iron and steel etc. The Government has fixed the price of sugar and has rationed the commodity. The unit for each individual is too small and therefore those who need sugar beyond their quota are compelled to go into the black market and pay price for sugar much above the controlled rate.

*Deflation.*—Deflation is the opposite of inflation. When money is pumped into circulation like air into a motor tube, the result is inflation of the currency and rise of prices, when money is withdrawn from circulation, the currency is reduced and prices fall. Deflation may also be caused by a sudden increase in the volume of production—the amount of money in circulation receiving the same. When deflation occurs currency appreciates. Deflation is injurious to the producers and businessmen and confers a corresponding benefit on the wage earners.

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## ECONOMICS—PART II.

1946

*Question 1* —Distinguish between money and credit. Does the supply of credit depend upon the supply of money ?

*Answer* —Credit in its literal sense means trust or confidence. Actually it means postponement of payment. A shopkeeper wishes to purchase goods from a producer for sale but he cannot pay for them straightaway. He, therefore, gives a written promise to pay the price of the goods some-times hence. In either case capital has been put by one man at the command of another to be re-paid at some future time. Credit, therefore, may be defined as a "protracted exchange," that is, exchange which is not complete until a certain period of time has expired. "Introduce the element of time into exchange," says Gide, "and it becomes credit..... credit may be defined as the exchange of present wealth for future wealth."

In fact credit involves three essentials viz. (1) exchange or transfer of value, (2) time and (3) confidence both in the integrity and capacity of the borrower.

Credit instruments differ from money instruments in more than one respect. They have no intrinsic value and circulate on the strength of the reputation and financial stability of a single person or institution. They pass less frequently and less rapidly from hand to hand and are seldom hoarded. Unlike money, all forms of credit do not possess the same degree of acceptability. A man's cheque or promissory note, for instance, will be taken only by people who know him and trust him whereas every one will accept a bank note. Credit may, therefore, be divided into two classes, (1) credit of general acceptability, such as bank notes, (2) credit of limited acceptability, such as bank cheques, drafts, and promissory notes.

Credit is not capital nor a factor of production in the same sense as land and labour are. Credit is only a method of production. It does not create wealth but transfers it. It represents money not in the hands of the owner but the borrower. Credit instruments are created if there is money to lend upon them. Credit is not wealth in itself. However, confidence we may have in some one, his confidence alone will not enable him to raise capital, if none has got some

wealth to give him. But sometimes credit is granted by bankers far in excess of money they possess. Roughly, it has been estimated that if a banker possesses Rs. 10, he can grant a loan of Rs. 100. In so far as this happens there are people who say that credit is certainly wealth. But the fact is that this multiplied wealth has for its basis some real wealth without which it could not have come into existence. We can, then, say that credit multiplies wealth and when it is used for production it gives it the form of capital. In short credit makes wealth more useful. It is not, therefore, a factor of production, but a method of production. It makes capital more efficient in the same way as division of labour makes labour more efficient.

*Question 2.*—How are trade cycles generated? Why does the boom collapse after a certain stage?

*Answer.*—See Answer to Question No 1, *Economics* 1937.

*Question 3.*—Compare and comment on the increase in note circulation and the rise in prices in India during the War.

*Answer*—The most outstanding fact of the currency situation in India since the war began is the enormous expansion of currency and extremely high prices.

The total amount of notes and coins in circulation increased by Rs. 503.72 crores during the period September 1939 to December 1942. Nearly a quarter of the total increase occurred up to March 1941. From March 1941 to March 1942 the increase was more than a quarter of the total. The remaining increase occurred between March 1942 and December 1942. The increase in currency was largely brought about by an increase in notes, coins being relegated to a very minor position. Notes in circulation increased by 38 per cent from September 1939 to May 1940. From June 1940 to October 1940 notes in circulation declined, showing the usual seasonal absorption, and then steadily increased, reaching a level above that of June 1940 in February 1941. From that time onwards notes in circulation have continuously increased up to December 1942, except for two small seasonal recessions, one in July 1941 and another in June 1942.

The total notes in circulation increased from 2,67,66 lakhs in 1941 to 6,43,58,000 in 1943 to 8,82,49,000 in 1944 and to 12,18,77,000 in 1946.

It would not be irrelevant to explain why this expansion occurred. Under the Reserve Bank of India Act an expansion in currency can occur only if there is a corresponding increase in the assets of the Issue Department of the Reserve Bank of India. The period of war, the assets of the Issue Department consisting of gold coins and bullions have received steady at Rs 44.42 crores. The largest increase occurred in sterling securities held by the Issue Department. The rupee securities had increased from Rs 37.39 crores in August 1939 to Rs. 126.13 crores in December 1942, an increase of 238 per cent. To enable the Reserve Bank to hold the additional rupee securities the Government of India issued an ordinance of February 10, 1941, modifying the provisions of the Reserve Bank of India Act. Under this act the amount of rupee securities and internal bills of exchange that could be held in the Issue Department was restricted to a maximum limit of one-fourth of the total assets or Rs 50 crores, whichever was greater. The ordinance did away with this restriction, and the new limits that it laid down were that no less than two-fifths of the total assets of the Issue Department should be held in external assets, i.e., gold coin and bullion or sterling securities, and that the value of gold held should not be less than Rs 40 crores. Accordingly up to three-fifths of the total assets can now be held in rupee securities, rupee coin, and internal bills of exchange.

The sterling securities in the Issue Department increased from Rs. 59.50 crores in August 1939 to Rs 412.83 crores in December 1942, an increase of about 580 per cent. From August 1939 to July 1940 the sterling securities increased by 121 per cent and remained stationary at that level up to December 1940; they showed a small rise during January 1941. In March 1941 they sharply declined by 27 per cent from the February 1941 level. After this an upswing began, and the January 1941 level was attained, and passed, in August 1941. They continued to increase up to March 1942, when there was again a sharp decline. Since then they have continued to mount up.

The sterling securities in the Issue Department rose from Rs 16,500 lakhs in 1942 to 643,52 lakhs in 1944 and to 10,61,25 lakhs in 1946.

The explanation for the increase is not far to seek. His Majesty's Government paid for its purchases in India in sterling and the sterling balances were kept in India. The Government of U.S.A. also made its payments in sterling



to the Government of India for the upkeep of the American troops and the latter provided the requisite rupee finance. This also tended to increase the sterling balances held in London on India's account.

In order to provide the equivalent rupee finance they are transferred from the Banking to the Issue Department of the Reserve Bank of India, and against them rupee notes and coins of equivalent amount are issued and made available in India. The sterling securities cover the new notes issued. As had already been pointed out, under the amended provisions of the Reserve Bank of India Act, once the statutory amount of gold coins and bullion (Rs 40 crores) is maintained in the Issue Department there is no restriction on the Reserve Bank as to the amount of sterling securities that can be held in that Department. The bank can increase its sterling assets almost indefinitely, and is, in effect, entitled to print notes worth about two and a half times their total value. As the sterling balances in London increased the notes issued to India also increased.

We can now consider the degree of responsiveness between currency expansion and the rise of prices. For a proper examination of this problem the relation of price changes with changes in the notes in circulation should be considered. The reasons for adopting this procedure are as follows. Firstly, the largest part of the increase in currency since the war began consists of notes. Secondly, by deliberately confining ourselves to notes in circulation, we can for the most part eliminate the element of hoarding. In India, hoarding of currency is largely confined to rupee coins and more recently to smaller coins.

As the bulk of the purchasing power in India consists of notes and coins, the volume of currency has a direct bearing on the price situation in this country. The connection between the volume of purchasing power and the level of prices might also be expected to be closer during war when there is a scarcity of consumers goods and conditions of full employment obtain.

During the first four months of the war prices clearly outpaced the expansion of notes in circulation. Prices then rose chiefly because of the development of speculative bulges in the expectation of still higher prices. The increase in note circulation thus followed the rise in prices and did not initiate it. Then came a recession in prices. But though

prices fell from January 1940 to September 1940 by about 17.4 per cent, there was only a contraction of circulation about 11 per cent, during the period May 1940 to October 1940. The area of large purchases in India by U.K. began some time during this period. From that time onwards notes in circulation and prices both show almost a continuous increase with prices clearly lagging behind. The prices follow the rise in the note circulation at a distance of time and the distance between them seems to be increasing. The implications are clear. The expansion in currency does not take place following price increases. As already indicated it is related to the sterling securities in the Issue Department which in turn are related to the needs of the British Government. Thus the expansion of notes circulation in India has been governed by the needs of British Government for rupee finance rather than by the needs of the Indian economy. Prices instead of catching up with the increase in note circulation are being increasingly out-distanced by it.

The following table sets out in juxtaposition the increase in Note Circulation and Demand Deposits and the calculated Index of wholesale prices :

	Note Circulation (In Rs crores)	Demand Deposits	August 1939-100 Calculated Index of Wholesale Prices.
1939 August	179	136	100
December	236	138	137
1940 January	238	139	130
October	229	162	121
1941 January	245	169	121
August	277	195	151
1942 January	356	217	155
August	474	295	192
1943 January	593	345	250
October	782	466	334
1944 April	894	565	298



trends in domestic as well as internal price levels. The discrepancy between the internal and external value of the currency that we find in India is true of other countries also where war-time controls have inevitably created the same problem to a smaller extent. In a word, not only India, but the U.K., the U.S.A., France, in fact, all major countries, are now faced with the problem of deciding the level at which to stabilize internal prices and the ratio of exchange.

The problem is complex and highly dynamic. The traditional approach of this problem is through an estimation of the purchasing power parity between different currencies. This formula is even theoretically open to several objections. In practice it is of much more limited applicability on account of the fact that internal price levels to-day do not reflect the purchasing power of the currencies in question because of the operation of war-time controls. In India the forces of inflation have been allowed to progress unchecked and prices have risen, as we have seen, to two and a half to three times the pre-war level. In U.K. the level of prices has risen by about 70 per cent and in U.S.A. by 40 per cent. The cost of living in U.K. as well as in U.S.A. by 40 per cent. The cost of living in U.K. as well as in U.S.A. has been controlled rigorously, the rise being about 30 per cent over the pre-war period. In India, although food prices have been controlled, there has been no attempt at subsidizing the basic articles of consumption so that the cost of living has risen almost to the extent of the level of prices. This means that if we compare the purchasing powers of the Indian, British and American currencies on the basis of these figures, the rupee would have to be devalued very sharply in order to bring our level of prices in equilibrium with the level of prices elsewhere. On the other hand, it has to be borne in mind that the present levels of prices and cost of living in the U.K. and the U.S.A. are lower than would be warranted by the amount of monetary circulation. In other words, the inflation potential in these two countries is larger than in India where the effects of inflation have been allowed to work themselves out much more fully than elsewhere.

We must also consider in this connection the requirements of our domestic economy. There are several considerations to be taken into account here. The present level of prices has inflicted great hardships on large sections of the people whose incomes have not risen *pari passu* with the level of prices. There seems to be, therefore, a case for lowering prices so as to afford relief to these classes. On the other

hand, if the prices are allowed to fall to low, they would affect agriculture and industrial enterprise adversely and thus create conditions of slump in the country. It seems reasonable, therefore, to work for the third alternative mentioned above, viz., to secure a *via medea* between the present high level of prices and the very low level that would be necessary in order to maintain the present ratio. The proper adjustment along these lines cannot be secured by different countries acting in isolation. Some kind of an international organization is necessary to prevent the sort of exchange disorders as characterized the inter-war period and to make possible a harmonious readjustment between price levels and exchange rates of the major trading countries of the world. The International Monetary Fund is an attempt in this direction.

**Question 5.**—What are the main functions of a Central Bank? How far does the Reserve Bank of India discharge them effectively?

**Answer.**—Central banking has acquired so much importance that it has now become an entirely separate branch of bank as distinct from the functions and operations of commercial banks, industrial banks, agricultural banks and so on. A Central Bank is generally recognised as a bank which constitutes the apex of the monetary structure of its country and which performs as best it can in the national economic interest, the following functions:—

- (1) The regulation of currency in accordance with the requirements of business and the general public, for which purpose it is granted either the sole right of note issue or at least a partial monopoly thereof.
- (2) The performance of general banking and agency services for the state.
- (3) The custody of the cash reserves of the commercial banks.
- (4) The custody and management of the nation's reserves of international currency.
- (5) The granting of accommodation, in the form of rediscounts or collateral advances, to commercial banks, bill brokers and dealers, or other financial institutions, and the general acceptance of the responsibility of lender of last resort.

- (6) The settlement of clearance balances between the banks, and
- (7) The control of credit in accordance with the needs of business and with a view to carrying out the broad monetary policy adopted by the State.

A further requisite of a real central bank is that it should not, to any great extent, perform such banking transactions as accepting deposits from the general public and accommodating regular commercial customers with discounts or advances. It is now almost generally accepted that a central bank should conduct direct dealings with the public only in such forms and to such extent as in the circumstances of the particular country, it considers absolutely necessary for the purpose of carrying out its monetary and banking policy. If a central bank has a large commercial banking business such operations might come into direct conflict with its functions as the bankers' bank, the lender of last resort and the controller of credit. It has, for example, come to be recognised over a wide range of countries that the success of a central bank depends largely upon the whole-hearted support and co-operation of the commercial banks, and that such co-operation can be effectively obtained only if it refrains from competing directly with them in their ordinary banking business, except when compelled to do so in the national economic interest.

Let us now explain how the Reserve Bank of India discharges the above functions —

*Monopoly of Note Issue* — The Reserve Bank of India has the monopoly of note issue. No other bank or the Government has this right. The bank assumed liability of all the notes of the Government of India already in circulation on the date of its commencement of the business. The bank issued its own notes for the first time in 1938. It has been given the right to issue notes on the proportional reserve system. The Bank is required to keep not less than 40% of the value of notes issued in gold and sterling securities, of which the amount of gold coin and bullion must not fall below Rs 40 crores. The rest is kept in rupee coins, rupee securities, bill of exchange maturing within 90 days, etc. The assets of the Issue Department are kept separate from those of the Banking Department.

The bank does not only issue notes, it is in fact, the sole channel for the out and intake of all forms of legal tender currency. Besides its notes, there are one-rupee notes, rupee coins and other subsidiary coins in circulation in this country. They are all issued by the Government only through it. If the bank has a surplus of them, the Government takes it back.

(ii) *Bankers to the Government.*—The Bank is the banker to the Government. It keeps all the balances of the central and provincial governments. The bank also acts as an agent to the various governments for performing their financial operations at home and abroad. It manages all public debts and advises the various governments as to the suitability of the time with regard to their flotation. It also purchases sterling on behalf of the Government of India for payment of home charges.

(iii) *Banker's Bank.*—The Reserve Bank of India is the banker's bank. Every scheduled bank must maintain a minimum balance of not less than 5 per cent of its demand liability and 2 per cent of the time liabilities. In return the scheduled bank can rediscount bills of exchange or borrow from the Reserve Bank. Just as credit is given by the ordinary banks to a businessman the Central Bank gives credit to commercial banks by means of rediscounting facilities. The Central Bank is thus in a position to control undue expansion of credit and currency in a period of prosperous business activity and to control undue contraction in a period of depression and thus prevents a crisis.

(iv) *Maintenance of the External Value of the Rupee* — The Bank is responsible for the maintenance of the sterling value of the rupee. For this purpose, it is obliged to purchase and sell sterling for delivery in London at fixed rates in sums of not less than £10,000 at a time. In fact, a very great stress has been laid down in this country upon the maintenance of the sterling value of the rupee. Contraction of currency has been several times resorted to, with this purpose in view, though this has resulted in a shortage of capital for industries. It is rather more necessary to maintain the internal stability of a currency than the external stability. But, in the case of rupee, this has been sacrificed, the aim being just the opposite.

(v) *Reserve Bank as Clearing House*—The Reserve Bank acts as the Clearing House for scheduled banks at Bombay, Delhi, Madras, Rangoon, Lahore and Karachi.

(vi) *Maintenance of steady rates of interest*—The Reserve Bank was also expected to steady the rate of interest in different seasons of the year and between rural and urban areas. But this has not been done, perhaps due to the fact, that a very important constituent of the Indian money market, namely the indigenous banker is out of its control. Something must be done to co-ordinate his activities also.

*Question 6.*—State the economic functions of the Stock Exchanges and comment on the working of Stock Exchanges in India.

*Answer.*—See answer to Question No. 4. Economics, 1940.

*Question 7.*—Examine the trend of India's foreign trade in the inter-war period.

*Answer.*—The figures below may serve as an introduction to a discussion of the developments in trade in India during the inter-war period :—



Value in Crores of Rupees.

Year.	Imports	Exports.	Net Exports.	Year.	Imports	Exports	Net Exports
1919-20	231.70	336.02	+114.32	1931-32	130.04	161.30	+31.16
1920-21	347.56	267.76	- 79.80	1932-33	135.02	136.07	+ 1.05
1921-22	282.59	248.65	- 33.94	1933-34	117.30	151.17	+33.87
1922-23	245.19	316.07	+ 69.88	1934-35	134.59	155.50	+20.92
1923-24	237.18	363.37	+126.19	1935-36	136.77	164.60	+28.83
1924-25	263.37	400.24	+146.87		152.01	154.54	+ 2.53
1925-26	236.00	386.82	+150.82	1936-37	127.72	203.49	+74.77
1926-27	240.82	311.05	+ 70.23		144.08	192.41	+48.33
1927-28	261.53	330.26	+ 68.73	1937-38	177.22	189.77	+12.55
1928-29	263.40	339.15	+ 75.75	1938-39	155.51	169.97	+14.46
1929-30	249.71	318.99	+ 69.28	1939-40	168.95	213.08	+44.13
1930-31	173.06	226.80	+ 53.44				

The early post-war period was characterised by a trade boom caused by the removal of many of the war time prohibitions on exports as well as a gradual resumption of commercial relations with enemy countries. The demand for Indian produce was also very brisk from the Western Countries who wanted to reorganise their industries. The revival of trade, especially export trade, would have been even more striking but for the shortage of railway wagons, high prices, labour troubles, unstable foreign exchanges, the rise in the exchange value of the rupee and the continuation of restrictions imposed on exports of food grains owing to the failure of the monsoon in 1918-19. The pace of the boom was, in spite of all these handicaps, very fast and it was feared that soon slump would set in signs of which became visible in the latter part of the year 1920-21. The export trade was the first to be affected. The foreign markets of Great Britain, the U.S. and Japan who were all among India's best customers, were glutted with Indian produce the demand for which gradually fell. The countries of Central Europe which had been a valuable market for Indian exports in the pre war period wanted products of our country but as their resources had been shattered they could not make any purchases. The failure of rains in 1920 in India and the high prices of food-stuffs necessitated the restrictions on the export of food-stuffs. Exports to Japan fell owing to severe crisis which overtook that country. The Indian export trade was further paralysed by the exchange policy of the Government of India. The import trade on the other hand expanded considerably. During the War India's import requirements had been starved. After the cessation of hostilities huge orders were placed for machinery and other manufactured products which soon began to pour in. It is, therefore, no matter for surprise that there was a heavy balance of trade against India to the extent of Rs. 79.80 crores in 1920-21 which continued into the next year when it amounted to Rs. 33.94 crores. Recovery was seen after the year 1922-23. And so far as the import trade was concerned the trend towards the restoration of normal conditions was continuously in evidence till the year 1929-30. The progress towards gradual recovery was favoured by the stabilization of the European currencies, the improvement in the credit position of the Central European countries and the apparent settlement of the reparations questions by means of the Dawes Schemes in 1924.

Then comes the great depression following the collapse of Wall Street in October, 1929 which soon spread all over the

world. India could not remain unaffected. The main causes of this trade depression which dominated India's foreign trade during the year 1929-30 to 1933-34 may be summed up as follows :—

- (i) Over-production in the case of both raw materials and manufactured products.
- (ii) Monetary causes such as the accumulation of gold by America and France resulting in a depletion of gold reserves of Central Banks in other countries and the consequent deflationary policies followed by these banks.
- (iii) Political unrest in many quarters of the globe, notably in India, China and South America.
- (iv) Restrictions on trade in the shape of tariffs, quotas, exchange control etc. which became numerous during the era of exchange instability ushered in by the widespread abandonment of the gold standard.

The set back in the foreign trade of India can be clearly seen from table given above. The fall in the value of exports was mainly due to the heavy fall in the prices of agricultural raw materials and in the demand for India's staple exports. The fall in the value of imports was largely the result of the fall in the purchasing power of the people, the tense political situation in the country and the increase in home production of textiles and sugar stimulated by the policy of discriminate protection since 1924.

In 1933-34 Indian conditions generally showed some improvement and there were signs of recovery, at least in the export trade. The years 1934-35 to 1936-37 witnessed further economic recovery. In the earlier stages, improvement was confined to particular countries or industries but in 1936 the world appeared to have definitely emerged from the paralysing conditions of the great depression. The gradual depletion of stocks of primary commodities since 1934, the restrictions imposed on a voluntary basis on the production of various commodities, the collapse of the gold block under the leadership of France and the devaluation of erst-while gold currencies in September, 1936 brought about a rise in the prices of many commodities.

India followed the general world trend towards recovery but her course of recovery was different from that of the other countries. India is an agricultural country and the depression of 1929 hit her most as there was a disastrous fall in the prices of primary produce. It was during 1936-37 that India saw an appreciable advance in the prices of her Agricultural products. This marked improvement was chiefly the result of a general recovery in the demand for primary commodities and raw materials. India's trade, especially her export trade, in consequence made a substantial recovery in 1936-37 when it recorded an advance of nearly Rs 36 crores over the previous year's total. In the same year the trade balances in private merchandise in favour of India which had sunk low to Rs. 3 crores in 1932-33 mounted to Rs 78 crores.

Then comes the period of business "recession" as it is called. It started in the United States in April, 1937 and soon gathered momentum giving an unexpected setback to the economic recovery of the world. This recession was caused by the bursting of the bubble of speculation, and nervousness regarding future shortage of raw materials resulting in the gold scare in the United States, the restrictions placed on credit facilities by banks, and evolution of restriction schemes. The recession was, however, short-lived and in the early part of 1939 business activity regained its strength.

The economic 'recession' did not fail to affect adversely prices and agricultural conditions in India. The prices of most Indian staple products declined sharply and this meant a shrinkage in the income of the agriculturists. The Sino-Japanese conflict affected seriously the trading capacity of Japan. India's principal customer for cotton. The foreign trade of India 1937-38 showed a fall in her exports compared with the previous year but there was an exclusion in imports. The figures for the year 1938-39 clearly bring out the effects of the "recession" on the foreign trade of India. The total value of India's foreign trade in private merchandise declined from Rs 363 crores in 1936-37 to Rs 322 crores in 1938-39. The fall of as much as Rs. 41 crores in exports was the result of general economic depression and reduced purchase of Indian cotton by Japan. The fall in imports in the same year was caused by the smaller purchasing power in the hands of the agriculturists.

*Question 8*—"Exports pay for imports" Discuss this statement, bringing out its relevance to commercial policy.

*Answer.*—In earlier times, imports of goods were paid for very often in gold and silver but such a method to-day would be very uneconomical for the following reasons.—

- (1) The world's stocks of specie, even if they were available as money would be sufficient to cope with the aggregate volume of business.
- (2) Transmission of specie involves expense and risk.
- (3) The precious metals would be diverted from internal use in arts, and if the country still used them as currency, from the currency system as well

It is, therefore, in the interests of all countries engaged in international trade to minimise the use of gold in international payments, and, as a rule, all the exports of a country are, in effect, set against all the imports. It is only the balance which is settled in coin or bullion. By means of the modern credit system, trade to the value of crores of rupees takes place annually with very little recourse to the transference of gold. In international trade, therefore, even more than in home trade, gold functions as a measure of value than as a medium of exchange.

Barter is at the basis of all exchange but it shows itself more prominently in international trade. Exports constitute a claim upon and payment for imports and foreign trade represents a reversion to barter. Imports of food and raw materials and exports of manufactured goods are reckoned in terms of money but the transactions, taken as a whole, are largely effected by mutual cancellation of debts. "Exports pay for imports" is also true in the sense that if there is no equilibrium between the total exports and imports (which terms include invisible items too) then there will be a balance of indebtedness against a country. But this general balance of indebtedness cannot go on increasing indefinitely and the unfavourable balance must be settled by the export of gold bullion or it will lead to either a readjustment of trade, an increase in export favoured by a depreciated exchange ratio and a diminution of imports or, in the end, national bankruptcy must ensue. The normal excess of exports of India over her imports arises chiefly from a steady demand for India's raw materials for use in foreign manufactures i.e., raw cotton in Japan and India's position as a debtor country and her standing obligation to meet the "Home Charges."

The proposition that exports pay for imports is, however, subject to the following explanations. —

- (1) Sometimes imports may be greater than exports because payment is postponed.
- (2) International loans for the time being tend to increase the imports of the borrowing country without an immediate equivalent increase of exports.
- (3) When the process of repayment begins the position is reversed and the borrowing country's exports tend to be in excess of its imports.
- (4) Under exports or imports all items—visible and invisible, officially recorded or not—are to be included.

The principle is the basis of clearing agreements which are designed mainly to regulate bilateral trade so as to produce as far as possible an exact balance of exports and imports. No payments for settlements are intended.

*Question 9*—Examine critically the effect of World War II on Indian industries, and give an outline of a proper post-war industrial policy for India

*Answer*—The Second Great War came as an expected god send to Indian industries, although it must be confessed, the best utilisation of the opportunity has not been made largely on account of the hostile attitude of the Government of India taking order from His Majesty's Government. In a total war where possibilities of industrial development were great India should not have been able to develop key industries is a matter for discredit to her rulers. In the first place there has been a shortage of machinery and plant. India does not manufacture plant and machinery and depends upon foreign countries for their supply. A number of industries which could have been established were prevented from so doing on account of the refusal of grant facilities for the import machinery from abroad. Secondly, the shortage of shipping was a major problem. Thirdly, the apathy of the Governments did not help India to realise the high hopes which were raised when the war broke out. The Government of India and the provincial governments took an extremely narrow view of what kind of industry deserved to be encouraged on the basis of war needs. According to them any industry which could not deliver its goods within a year or so was not to be regarded as essential

for war purposes. This was to fly in the face of both the experience of the last war and of common sense and common prudence. In the result the motor car industry for which all plans were got ready by a private enterprise working in collaboration with an American firm was refused facilities for importation of machinery and guarantees of purchase for the army. The ship-building industry which cried for expansion was restricted on the same grounds, and the Secretary of the Department of Commerce said in 1941 that the Government had no intention of encouraging ship-building industry as part of the war effort. Indeed for quite a considerable time all that the war effort meant was the collection of funds under varying degrees of official pressure to be remitted to Britain for the purchase and naming of a few fighter planes on the ground that India's best defence was in Britain's and that she herself need not do anything. Despite the unfortunate and unforgettable experience of the previous war the government persisted in pulling out rails and tracks and sending rails, wagons and locomotives to the middle East and other theatres of the war without making any preparation for replacing them or rebuilding them. Transport which at no time was adequate later became pitifully insufficient to meet the strain imposed on it.

Yet in spite of all these obstacles India's industrial development was not checked. The existing industries have made great progress and several new industries have come into being. The annual output of steel increased from about 750,000 tons in 1939 to about 1,125,000 tons in 1943-44. New kinds of steel, like special alloy and acid steel were for the first time manufactured. Whole railway wagons including wheels, tyres and axles are being constructed and armoured plates and armour piercing steel are also being manufactured at Jamshedpur. The result of the developments in the steel industry during the war has been striking. Auxiliary industries have grown up and the essential foundation for the establishment of new industries is being laid. Indeed, the steel works in India have promised to build locomotives after the war and to supply the various parts required for the manufacture of motor cars.

In addition, advances in the supply of machine tools, structural steel, heavy mechanical appliances, electrical equipment, optical stores, paint and chemicals have been made. Before the war only 100 machine tools were made, in 1944, 4,500 machine tools were produced. As against 600 engineering workshops before the war there were by the middle

of 1943, 1,500 including 23 railway workshops. The production of aluminium is now fairly well established and has a capacity of about 5,000 tons of ingots and several manufacturing processes in connection with the rolling of nonferrous metals have been developed. The cotton industry has increased its output from about 4,000 million yards to 5,000 million yards and entered into new lines of production. Tentage items, mosquito nets, parachute silk are some of the new lines of development. The woollen industry which was completely taken over by government had also increased its output. Both the handloom and machine-knitting industries have developed rapidly. Perhaps the most outstanding achievement was in the leather industry. From a bare 100,000 pairs produced before the war for defence services, the supply rose to 3.6 million pairs in 1941, 5.9 million in 1942 and 6.6 million in 1943. This increased supply came both from the bigger firms and the smaller producing units. The increased demand for harness, saddlery and other army equipment was also met by the leather industry. As against 3,000 workers employed in 1939, 20,000 are now employed and production is now roughly 20 times the peace-time output. Again grinders the production of heel and two tips, eyelets, etc.,—formerly imported—is now produced in India to the tune of 30 million pairs.

The chemical industry which had been established on a small scale before the war was able to expand considerably. Before this there were 23 factories producing only 26,000 tons of Sulphuric Acid. The demand having increased to 115,000 tons and imports of base materials not being available, production was stepped up. Six more plants were established but total production is still short of requirements by 93,000 tons. Attempts made to secure four contract plants under lend-lease from the U. S. A. have not succeeded. But notable improvements have been registered in the production of Nitric Acid, Copper Sulphate and bichromates, all requiring Sulphuric Acid as basic raw material. The deficiency in the production of caustic soda, bleaching powder, chlorine, soda ash, sodium bicarbonate, alums and number of other chemicals still remains. The absence of a well-developed basic chemical industry and of a heavy engineering industry which was felt to be a serious gap and limiting factor in the last war continued to be so during the present war.

Owing to the stoppage of imports, the Indian production of drugs has received great fillip. About 60 per cent of drugs used are now manufactured in India. The development of our



surgical dressing has also been rapid. Considerable success has been achieved in expanding industries connected with the manufacture of brushware, enamelware, crockery, cutlery, paper, cardboard products, glass, safety-razors and a number of such small items. The canning of fruit has also developed from 1.5 million to 2.6 million cans. Timber, plywood, wood-ware and production connected with timber received some stimulus and production increased from 242,000 tons in 1940-41 to 863,000 tons in 1942-43 and to 963,000 tons in 1943-44. In shipbuilding and aircraft manufacturing, no progress was possible. But repairing work, never before done in India, has been going on both in regard to ships and aeroplanes. The Hindustan Aircraft factory established for production has been used only for the maintenance and repair of aircraft.

War has come to an end. We must not allow the work built up during the war to crumble down. What the future policy of the Government to protect the industries should be only time can tell but it is necessary to protect industries whether by tariffs or subsidies.

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## ECONOMICS—PART II]

1947

*Question 1* —What is the relationship between the supply of money and the general level of prices in a money economy?

*Answer* —While answering this question the reader has to discuss the Quantity Theory of money and for a discussion please see answer to Question No 1, Economics, 1943

*Question 2.*—How does a high or low exchange ratio affect the different economic interests in India?

*Answer* —If the exchange value of the rupee were reduced the effects on India's trade, industries and agriculture would be beneficial to the country

*Trade* —A low rate of exchange acts as a stimulus to exports, as the same can be sold in foreign markets at low prices without at the same time lowering the proceeds available to the exporters. The foreign importers shall have to pay less in their own currency while the Indian exporters being paid in rupees do not lose anything. For instance if the exchange value of rupee were to be reduced from 1s. 6d to 1s 4d prices of Indian exports would be automatically reduced by 1/9. India has in recent years been building up a fairly good export trade in manufactured goods. Foreign competition for the same would, by lowering the rate, be eliminated to some extent. Besides imports would fall as their prices would rise in the same proportion and the importers would be discouraged from importing foreign goods.

It is, however, urged that this may not happen if probative duties are levied by foreigners on our exports and bounties are given on imports. But this cannot be so as most of our exports comprise foodstuffs and raw materials which must be purchased by foreign countries. Moreover, our manufactured goods are exported to countries having no manufacturing and hence they would not like to place restrictions on them.

(b) Internal trade would also develop inasmuch as we shall have a greater purchasing power in the hands of the producers.

(c) *Industries*.—A lower rate of exchange would give stimulus to our exports of manufactured goods and a setback to our imports. This would naturally keep the development of our industries. More goods would be required for foreign as well as home markets. It is argued that a lower rate of exchange would increase the cost of machinery which we shall be required to import. It may be so, but this would not retard the industrial development. It is pointed out that India may herself begin to manufacture machines

*Agriculture*.—A lower rate of exchange would benefit the agriculturists. They would be able to increase their exports and their profits too. It is, however, said that they being ignorant might not be able to derive full benefit and the higher profits would be taken away by the middlemen. But this is not true in these days of competition. A part of the profits would surely go to the agriculturists.

*Question No. 3*.—What are the main functions of a Central Bank? Show how far the Reserve Bank of India performs these functions effectively.

*Answer*—See Answer to Question No. 5, 'Economics 1946.

*Question No. 4*.—Examine the character and composition of our foreign trade during 1939-45. How does this period compare in these respects with the periods (a) 1914-18, and (b) 1919-39?

*Answer*.—The effects of the war on India's foreign trade have not on the whole been injurious. But the lack of a sound export and import policy has resulted in serious dislocation of her economy and failure to develop her own industry. The following table gives the figures of export and import trade for the year 1938-39 to 1943-44. It must be noted, however, that these figures give a wholly incomplete view of trade because trade on government account and lend-lease export and import are excluded from these figures. This detracts greatly from the value of the figures, but such as they are, they will be useful.

	1938-39			1939-40			1940-41.		
	Imp.	Exp.	Bal.	Imp.	Exp.	Bal.	Imp.	Exp.	Bal.
(In Crores of Rupees)									
Total trade .	152.3	162.8	10.5	165.3	203.9	38.6	157.0	187.0	30.0
	1941-42			1942-43			1943-44		
	Imp.	Exp.	Bal.	Imp.	Exp.	Bal.	Imp.	Exp.	Bal.
Total trade .	173.3	231.6	58.3	110.5	137.6	27.1	118.0	199.2	81.2

Countries (In percentage):-

	1938-39 Imp. Exp.	1939-40 Imp. Exp.	1940-41 Imp. Exp.	1941-42 Imp. Exp.	1942-43 Imp. Exp.	1943-44 Imp. Exp.
United Kingdom	30.5 34.1	25.1 35.1	22.8 34.7	21.1 32.4	26.8 30.5	25.1 30.2
Australia	—	1.4 2.7	1.6 3.9	2.9 5.2	—	—
Total British Empire	58.1 52.4	56.3 55.9	57.3 62.4	61.0 62.7	55.5 67.1	48.0 64.5
U " A.	6.4 8.5	7.1 11.9	17.2 13.8	19.9 19.5	17.3 14.8	15.5 20.2

The value of India's foreign trade declined the year following the outbreak of the war mainly on account of the fall of France and other countries, but recovered quickly in 1941-42. The export trade increased from Rs 187 crores in 1940-41 to Rs 233 crores in 1943-41 and the import trade from Rs. 157 crores to Rs. 173 crores. From the point of view of India's economy the effects were serious. The large and continuous export of food grains and other essential civilian goods was in part responsible for the intense scarcity which followed in 1943. Instead of scaling down exports and stimulating imports, the opposite policy was followed. The subsequent year brought about a fall both in exports and imports but while the quantum of fall was greater in exports the fall in value was greater in imports. In 1943-44 there was an increase in the value of lesser exports and imports, but in the case of exports the quantum was less.

The last war meant cessation of trade with the continent and later on with Japan, Burma and the other occupied countries. The relative share of the Empire countries in the imports has increased though that of the United Kingdom has continued to decline as previously. U. S. A. has gained most. Imports however increased from countries surrounding the Indian ocean particularly Egypt and the Middle East countries. Iran got as large a slice as 16 per cent of the value of the total imports in 1942-43. The relative share of the United Kingdom in the exports from the country declined but that of the Empire as a whole increased to more than 67 per cent. The increase has been particularly marked in the case of Ceylon, Australia, and South Africa. The importance of non-Empire countries in our export trade declined still further having been reduced to less than one-third. U. S. A.'s relative share during the war period has become increasingly important and so have exports to countries of the Middle East like Turkey, Syria, Arabia and Iran experienced substantial improvements.

During the period intervening the two wars the importance of the United Kingdom and the British Empire in the import trade of the country in spite of a policy of Imperial Preference and the Ottawa Agreement since 1932 deteriorated still further. The deterioration was most marked in the case of the United Kingdom whose percentage share in the import trade fell from 63 to 30 in 1938-39. At the outbreak of the present war Burma accounted for nearly 36 per cent of our imports and Japan's share increased from a mere 2½ per cent before the Great War to

more than 10 per cent in 1938-39. Germany's share also increased while that of U S A was more than doubled though it was not very important. On the contrary, the export trade tended to be concentrated more in the empire markets than outside it, particularly, after the Great Depression. The share of the United Kingdom had increased from 25 per cent to more than 34 per cent while that of the non-Empire countries decreased from 59 per cent to 46 per cent nearly.

*Question 5.*—What are the principles which guide the grant of protection in India? Illustrate your answer by reference to any two of the industries affected

*Answer.*—See Answer to Question No 8, Economics 1937

Paper industry is another industry which has immensely justified the anticipations of the Tariffs Board. In 1925 the industry was given protection till 31st March, 1932 at the rate of one anna per lb. The proposal of the Board regarding loans etc. was not accepted by the Government. The Bamboo Paper Industry Amendment Act of 1932 renewed the protective duty up to 31st March, 1939, as recommended by the Tariff Board. By the same Act a new protective duty of Rs 45 per ton was imposed on imported wood pulp to provide a stimulus to the manufacture of bamboo pulp in India. In 1939, the protection granted to the paper and pulp industry was renewed, but the rates were in some cases slightly reduced. The industry has immensely justified the anticipations of the Tariff Board.

The following table shows the progress which the paper industry has made since the grant of protection

## Paper Mills in British India.

	Authorised Capital.	No of Mills.	Tons Produced.	Price (Rs )
1933	1,14,62,500	9	43,206	1,79,36,760
1934	1,14,62,500	9	44,179	1,71,13,169
1935	1,19,62,500	10	47,305	1,89,87,797
1936	1,34,62,500	10	48,209	1,92,12,791
1937	1,81,13,500	11	55,593	2,48,13,096
1938	2,24,13,250	12	60,114	2,46,04,675
1939	3 74,13,250	14	70,273	2,96,29,258

**Question 6**—What are the functions of a Stock Exchange? Explain whether State Control investment will improve the utility of stock exchanges.

**Answer.**—The fundamental purpose of an organized exchange to quote the preamble of the constitution of the New York Stock Exchange is to furnish exchange rooms and other facilities for the convenient transaction of their business by its members as brokers, to maintain high standard of commercial honour and integrity among its members and to promote and inculcate just and equitable principles of trade and business." A Stock Market, in its simplest form, may be considered as a market for the purchase and sale of securities and its continued existence and development plays an indispensable role in a capitalistic society, having joint stock enterprise as its main feature. A Stock Exchange should be able to guarantee a free and continuous market for the exchange of securities and thus help in the determination of their real values. Because of their existence, investors are much convenienceed in converting their holdings in cash and this factor, in turn, is responsible in stimulating the flow of capital into industry. A Stock Market by providing a continuous market not only makes

possible the conversion of securities into cash or shares, but also facilitates international investment of funds, making international payments possible without shipment of gold.

"Stock Exchanges are not merely the chief theatres of business transaction, they are also barometers which indicate the general conditions of the atmosphere of business. They are very sensitive to changing political, social and cultural conditions. The trend of values on these market reveal the trends in economic prospects of various industrial units. Hence the industrialist, the investor, as well as the student of economics can feel the pulse of the nation by watching the trend of changing values on these markets. Like every other organized market, a stock market also aims at providing a continuous, free and a fair market, where buyers and sellers can come in contact and deal in shares and securities. It helps in providing a ready market where shares and securities can be exchanged and transferred with the minimum loss of time and maximum of profit.

The Stock Exchange serves a function by providing the necessary mobility to capital and directing the flow of capital into profitable and successful industrial enterprises and retarding its flow into enterprises with less justification for development. This facility provided by Stock Exchanges serves a desirable social function by furthering the existence of those industries which are more desirable. Thus not only capital is attracted but it is directed to more profitable channels. This is achieved by watching the price-movements on the Stock Exchanges. A rise in the price of a particular security, if it seems to be permanent, indicates that the future prospects of the industry are likely to improve and that the industry shall be in a position to absorb more capital with advantage. On the other hand a fall in the price of any group of securities indicates that the capital employed therein is being shifted to another group in which prices are rising prospectively. The interested persons and the investors, as a consequence, can feel where capital needed most and can formulate their investment policy accordingly. Thus the overflow of capital where there is no necessity and its scarcity where it is most needed are avoided and a fine balance is brought about between demand and supply. "Simultaneous gluts and scarcities of capital as between different industries are almost automatically prevented, misalignments between the supply of capital and the demands of industry are largely avoided and great economies in the use of capital are thus produced.



A Stock Exchange by providing a ready and continuous market enables an investor to withdraw his capital, at any time, either for personal requirements or for other capital investments. This is a very important consideration behind the investment of savings into industrial enterprises. But the extent of this privilege is limited. Stock Exchanges do not provide facilities for withdrawing funds from the industry as the capital once invested cannot be withdrawn but it provides the necessary facility for the selling of one's securities at whatever price available, and at sometime if too many people want to take advantage of this privilege, it shall lead to a drastic decline in values with a consequent loss to investors. But there is not the least doubt that Stock Exchanges make these investments liquid and easily disposable. This factor also adds to the collateral value of securities and enables its holders to obtain a substantial amount by way of loan from financial institutions on the strength of securities that are quoted on an organized exchange than on most other capital goods. Securities listed on the Stock Exchange become much more negotiable than those not so listed. This privilege of a continuous market also provides an advantage to the creditors who cannot only estimate the value of their collaterals on which they have advanced loans but can promptly liquidate them in times of emergency. Besides, a Stock Market by providing a continuous market leads to a continuity of prices and thus makes it practicable to place stop-loss order with the knowledge that they will be executed at or near the price where they become operative.

Organised Stock Exchanges work under certain definite rules and regulations which minimize the danger of forged securities passing as genuine. These regulations under which organized exchanges are required to work tend to inspire confidence in the minds of investors. An organized exchange is also recognized by government, banks, trusts, insurance companies and others mainly because of security of dealings. Scale of commission chargeable by broker is fixed and any evasion of that may lead to a fine, suspension or expulsion. In other words an organized exchange is instrumental in providing security and safety of contracts through its collective regulations, facilities and discipline leading to standard practices and affords the necessary protection to the investors. Constant quotation service provided by organized security markets further benefits the security owners and creditors. Buyers and sellers and the public in general are kept informed of market quotation service is not so advanced as in foreign countries where we have mechanical devices, yet its existence

provides an advantage not only to the members but also to the general public

It is suggested that in order to regulate the Stock Exchange markets properly it is necessary to have some form of Government control as under the present conditions speculation is ripe in the stock markets and it involves waste of the community's material resources. Speculation causes wild fluctuations which create a sense of insecurity and precariousness in the genuine investor who thus holds off from industrial investment. To get rid of this evil it is urged that the Government should introduce legislation to control Stock Exchange activities. If the Stock Exchanges are regulated by Legislative acts investors would have more faith in the Stock Exchanges and their usefulness would increase.

To eliminate or moderate the evils of the existing system it is suggested that

- (i) the forward dealings should be regulated,
- (ii) margins should be enforced,
- (iii) the period of settlement should be shortened and
- (iv) the scale of stamp duty on transfers should be lowered.

**Question 7** — What are the main components of the Indian money market? Indicate briefly (a) the functions they perform, and (b) what measures are necessary to increase their usefulness

**Answer** — The Money market and the banking system of India are made up of the following constituents — (1) The Reserve Bank of India, (2) the Imperial Bank of India, (3) the Foreign Exchange Banks, (4) the Indian Joint Stock Banks on Western lines, (5) the Co-operative Banks and (6) the indigenous bankers, brokers and money-lender known by a variety of names such as Shroffs, Multanis, Chettis, Marwaris, Mahajans, Sahukars, Banias and Nanavatis. The first four constitute the central part or the European money market, the last is the indigenous or the native money market. Co-operative Banks occupy a middle position. Other smaller constituents of the money market are Postal Savings Banks, Land Mortgage Banks, Industrial Banks and indigenous credit agencies like Loan Offices in Bengal and Nidhis and Chit Funds in the Madras Presidency. In the following pages a brief

account will be given of the more important constituents of the money market.

(1) The Reserve Bank performs both central banking and ordinary banking functions but the latter have been so designed to be performed by it as not to allow it to enter into competition with other banks of the country. For instance, the bank receives deposits but free of interest, discounts, bills of exchange etc., but bearing signatures of at least one of the scheduled banks or of a provincial co-operative bank. It grants credit only to various governments, states, local authorities and scheduled and provincial co-operative banks. Its central banking functions are the same as those of any other central bank. It has the sole monopoly of note-issue, and it is the sole channel for the in and outake of all currency. It is a banker to the various governments in the country, holds their balances, manages public debts, receives and pays on their behalf in India and abroad. It is also a banker's bank. Every scheduled bank has to maintain a fixed percentage of its liabilities with it. The bank helps them in times of need. It guides, supervises and controls them. It also collects and publishes various statistics regarding banking in this country.

(2) The Imperial Bank of India comes next in importance. It acts as an agent to the Reserve Bank of India. Besides it undertakes all the commercial banking functions. The financing of internal trade by allowing advances against commodities and by purchasing demand drafts against goods despatched forms another important function of the Bank. The financing of agriculturists indirectly by granting loans on gold ornaments has been recently taken upon by the bank. Caring solely for the stability and fluidity of its funds, it has all alone been playing the part of a premier commercial Bank of the country coming into contact with the Joint Stock Banks, Shroffs or Indigenous Bankers and the Co-operative Banks. It is now also allowed to do foreign exchange business.

(3) The Foreign Exchange Banks are the immigrant banks and specialise in financing sea-borne trade, both import and export. They have of late begun to compete with Joint Stock Banks both in the field of collecting deposits and in the making of advances. Some of them have penetrated into the inner parts of the country and are actively engaged in financing the internal trade of the country.

(4) The Indian Joint Stock Banks are mostly organised as banking companies and work on conservative lines adhering to strict commercial banking principles and attempt to satisfy the needs of their clientele without endangering their position of stability. The main object of these banks is to attract deposits of all kinds Current, Savings and Fixed. In the matter of advances, they discount local and inland bills, open cash credit accounts, and give loans against various kinds of securities. They remit money on behalf of their customers from one place to another, buy and sell shares and other Stock Exchange securities for the public and do other agency and safe custody work.

(5) The Co-operative Credit Banks are of relatively recent growth and they specialise in making short term loans and intermediate credit requirements available to the members of the societies affiliated to them. These banks were established primarily with a view to financing the Indian cultivator, and though, at the present time, a number of co-operative credit societies exist in the urban areas also, the Co-operative Credit movement is, on the whole, a rural rather than an urban achievement. The Co-operative Banks have not as yet established a close contact with the money market.

(6) Lastly come the Indigenous Bankers who combine trade with banking and advance loans on immovable property even. They hardly ever make it a policy to accept deposits because they generally view this kind of business as a source of weakness rather than strength. They finance the agriculturist, assist in the movement of crops to the consuming centres and to the ports, and act as distributing agencies for all kinds of goods. Inland exchange and inland remittance form peculiarly the province of the indigenous bankers. Their main business consists in making advances on every kind of security, promissory notes, hundis, land, or jewellery and to deal in hundis or internal Bills of Exchange.

"These are the waters of the different or diverse streams of credit, each following in its own circumscribed channel, and the Imperial Bank which stands at the apex vainly strives to collect the waters into a mighty stream or reservoir and distribute it adequately to fertile the fields of agriculture, trade and industry of the country"

Before the establishment of the Reserve Bank of India, there was no co-ordination amongst the above units. They

suffered also from the lack of leadership. Since the establishment of the Reserve Bank of India, however, these evils have been removed but only partly. We know that there are non-scheduled banks which work even now without being subject to any control from the Reserve Bank. Then, there are the loan offices, *midhis*, *chit funds* and various other indigenous bankers including money-lenders which are outside its control. In short, we may say that the Indian money market consists of the modern and indigenous bankers, and of those modern bankers (though not all, yet those forming important element) are subject to the control of the Reserve Bank of India, however small it may be, while the indigenous bankers act as independent units.

The relations between the various units of the Indian money market are much less than what are desired for. To remove the above defects and make the money market a well-knit unit several suggestions have been made. They include the linking of the indigenous bankers with the Reserve Bank, the extension of the control of the latter over non-scheduled banks and strengthening of the relations between different constituents.

The will of a community to save depends to a large extent upon the opportunities afforded to it by the existing credit institutions for safe investment. The banks in India have rendered a great service in creating and fostering the habit of thrift amongst the Indian people. The various classes of banks now accept deposits in different forms at suitable rates of interest and have succeeded in drawing from the hoards large sums of money which otherwise would have remained idle or been spent on wasteful expenditure. But accepting deposits for short and long periods they give opportunity to depositors of all kinds for making deposits of their surplus funds with banks. Some banks supply small beautiful safes to their clients for accumulating their savings and by this and other means the banks hope to inculcate the idea of thrift amongst the children of the soil. Considering, however, the vastness of the country, the number of banks is very small and the needs of the people cannot be fulfilled by the existing banking institutions.

*Question 8.*—What is the position of large-scale industries in our economy to-day? What do you think should be their place in the future economy of the country?

*Answer.*—The development of large-scale industries along modern lines has been of recent origin in India; most of the industrial concerns of this type have come into existence during the later half of the 19th century. Though India has had a late start in this field and she is still far behind the industrially advanced countries of the world, yet in with respect of her total industrial production and the number of persons employed in such industries she ranks among the first six leading countries of the world. An idea of her varied industrial activities and the extent thereof can be formed from the following tables —

Large Scale Industrial Establishments in India (1937).

Kind of Establishment.		Number.	Persons employed.
1.	Textiles	832	916,575
	Cotton (Spinning, Weaving and other factories)	423	569,025
	Jute Mills	105	308,715
	Silk Mills	69	6,917
	Woollen Mills	18	8,075
2.	Engineering	928	217,443
	Dockyards	8	4,328
	Electrical Engineering	57	8,653
	General Engineering	326	44,407
	Railway Workshops	165	108,924
	Shipbuilding and Engineering	13	14,755
3.	Minerals and Metals	154	57,433
	Foundries	78	4,527
	Iron and Steel Mills	13	42,158
	Petroleum Refineries	4	2,479
4.	Food, Drink and Tobacco	2,774	240,617
	Flour Mills	74	6,071
	Rice Mills	1,009	43,882
	Sugar Factories	175	79,078
	Tea Factories	99	67,101
	Tobacco Factories	30	10,984

Kind of Establishment.			Num-ber.	Persons employed.
5.	Chemicals, Dyes, etc. ...	...	632	65,484
	Dyeing and Bleaching ...	...	76	9,391
	Chemicals ...	...	28	4,687
	Matches ...	...	118	16,363
	Oil Mills ...	...	265	16,949
6.	Paper and Printing ...	...	489	51,174
	Paper Mills ...	...	12	8,005
	Printing, Book-binding etc. ...	...	452	40,926
	Paper Pulp ...	...	1	719
7.	Process relating to Wood, Stones and Glass ...	...	484	85,807
	Tiles and Brick Factories ...	...	142	16,290
	Saw Mills ...	...	50	3,844
	Glass Factories ...	...	63	7,997
8.	Processes connected with Skins and Hides ...	...	73	14,067
	Leather and Shoes ...	...	12	6,510
	Tanneries ...	...	39	6,126
9.	Gins and Presses ...	...	2,804	227,545
	Cotton Ginning and Baling ...	...	2,526	981,898
	Jute Presses ...	...	101	36,308
10.	Miscellaneous ...	...	252	64,332
	Grand Total ...	...	9,422	1,940,477

The above table indicates the varied industrial activities followed in India.

The Second Great War has given a fillip to our industrial development. Large Government orders coupled with growing civilian demand due to a stoppage or curtailment of foreign imports brought about an all round prosperity in the industrial sector of our economy. An idea of our industrial prosperity can be formed from the fact that whereas India was a debtor nation before the war she has become a creditor nation and

Great Britain owes us a sterling debt to the tune of over Rs 1,000 crores. New large scale industries like motor engines manufactures, aircraft construction, shipbuilding and cycle manufacturing have come into existence.

In spite of all the progress India has made in the industrial field she is still largely an agricultural country and if the lot of the Indian people has to be improved it is necessary that India should be properly industrialised. India possesses vast resources of water power, raw material and labour necessary for the establishment of key industries. In iron and steel it is claimed that we produce the basic and foundry pig iron of such high quality and at such low costs that in the per-war period in some cases in spite of high protective duties we were able to compete successfully in the markets of Japan, the U.K., U.S.A. and Europe. The ordinary B.S.S. mild steel was produced at no higher costs than in any other large steel producing country. The position is equally favourable with regard to iron and steel alloys. Yet our total steel production in spite of the increased war time capacity is no more than a very minor fraction of the, war-time increase alone in steel production of U.S.A. Tremendous stride have to be taken as there are great opportunities. With the expansion of the iron and steel industry, the establishment of heavy engineering industries should be a concurrent step. The manufacture of locomotives, automobiles, aircrafts, internal combustion engines, power and industrial machinery and machine tools shall lay the foundations of our industrial progress on permanent footings. It can therefore no longer be delayed. Likewise is the case of heavy chemicals and it is satisfactory to note that significant progress has been made in this direction since the outbreak of the hostilities. But much still remains to be achieved, for which the chances are exceptionally bright. Cotton Textile industry affords scope for expansion. The products of the Indian industry have already found a market for themselves in the neighbouring countries. India has made such rapid strides in sugar production that she became an exporting country for sugar.

*Question 9.*—Write short notes on any four of the following.—

- (a) The Gold Exchange Standard,
- (b) Imperial Preference;
- (c) The International Monetary Fund,
- (d) The Balance of Payments,
- (e) Industrial Fluctuations.



*Answer.—*

(a) *The Gold Exchange Standard.*—See answer to Question No. 3 (3) Economics 1937.

(b) *Imperial Preference* —Under the Imperial Preference scheme the goods of the countries forming the union are given more favourable treatment through tariffs. That is the tariff duties upon the goods of the member countries are to be assessed at a lower rate than goods from countries outside the union. Imports from foreign countries are taxed by all members of the union at a uniform rate. It is not necessary that there should be free trade between the members of the union. Duties may be imposed on goods imported from member countries but the chief feature of Imperial Preference is the taxation of goods of the member countries at lower rates than foreign imports.

(c) *International Monetary Fund.*—See answer to Question No. 9 (a) Economics 1945.

(d) *The Balance of Payments.*—The balance of exports and imports of merchandise alone in modern times does not constitute the true balance of accounts. There are other items of credit and debit, which together constitute the true balance of accounts, and these show whether a country is a debtor or a creditor country. They are called the invisible imports and invisible exports. Let us examine the main items of India's credit and debit.

#### Credit Side

1. Value of exports of merchandise (including treasures).
2. Imports of capital into India by way of commercial investments.
3. Government borrowing abroad
4. Private remittance by foreigners in India for meeting the expenses of foreign tourists.

#### Debit Side

1. Value of imports of merchandise.
2. Interest of foreign capital invested.
3. Freight charges paid for the services of foreign ships.
4. Commission and premiums paid to foreign banks and insurance companies.

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Credit Side	Debit Side
5. Private charitable endowments by missionaries and others	5. Government borrowings abroad.
6. Proceeds of the sale of Sterling bills for meeting the expenses of the Secretary of State for India.	6. Private remittances by Indians for meeting the expenses of travellers and students studying abroad.
	7. Sterling bills despatched to the Secretary of State for meeting the expenses incurred on behalf of India and Home Charges.
	8. Pensions, furlough, store purchase, etc.

## ECONOMICS.

1948

*Question 1.*—How is the value of Money determined ?

*Answer.*—See answer to Question No. 1, Economics, 1943.

*Question 2.*—What are the conditions under which a boom is followed by a depression ?

*Answer.*—See answer to Question No. 1, Economics, 1937.

*Question 3.*—Discuss briefly the position of the rupee since 1939 to the present time.

*Answer.*—During the decade before outbreak of the present war the Government found it difficult to maintain the rupee-sterling rate at 1s. 6d. It was accomplished partly by contraction of currency and partly on account of the export of gold after 1931. The chief cause of the difficulty was the serious falling off in our exports surplus during the period of acute agricultural depression. With the outbreak of the World War II our export surplus revived on account of considerable export of raw materials from India purchased on behalf of the British Government. Indian exports of merchandise to foreign countries (mainly the United Kingdom and the British Empire) increased from Rs. 163 crores in 1938-39 to Rs. 203 crores in 1939-40, an increase of about Rs. 40 crores during the first year. The imports into the country, on the other hand, were kept down by means of import restrictions from May 1940 onwards. The favourable balance of trade in merchandise was only Rs. 17.3 crores for the pre-war year 1938-39 and Rs. 48.8 crores for 1939-40, Rs. 41.9 crores for 1940-41, Rs. 79.9 crores for 1941-42 and Rs. 84.61 crores for 1942-43, Rs. 90.9 crores for 1943-44 and Rs. 26.1 crores for 1944-45. This surplus export balance enabled the Reserve Bank to buy sterling in large amount and there was no difficulty in maintaining the rate at the statutory level of 1s. 6d. Below are given sterling purchases by the Reserve Bank along with the annual average rate at which purchases were made —

Year.	Net Purchases £ million	Average rate of Purchase.
1931-32	25 46	1 5 15/16
1939-40	52.59	1.5 63/64
1940-41	57.08	1.6
1941-42	73 31	1 6
1942-43	91 67	1.6
1943-44	105.31	1.6
1944-45	91.80	1.6

It may be added that some trouble was, however, felt in March, 1941, when owing to continued difficulty in securing shipping space there was a scarcity of export bills and the exchange weakened but the Reserve Bank was able to meet the situation by offering to sell Reserve Bank Council Bills at 1s. 5 $\frac{3}{4}$ d.

While the rupee remained firm in relation to sterling it depreciated in terms of dollar, yen and the continental currencies following the slump in the pound. When the sterling pound was pegged to dollar at 4 02 the rupee dollar exchange also became steady at about Rs. 332 per 100 dollars.

Thus, externally the rupee has remained stable at 1s. 6d. But internally its value depreciated due to increase in note of Reserve Bank in active circulation in India. On the 19th of October, 1945, this figure stood at 1159 85 crores and on 11th September, 1948, Rs 1217 24 crores (including those in circulation in Pakistan).

Side by side with this expansion of currency there was an enormous increase in the general price level as shown by the table given below.—

# INDEX-NUMBER OF WHOLESALE PRICES IN INDIA

(Week Ending 10th August, 1939=100).

Year	Agricultural Commodities	Raw Materials.	Manufac- tures.	General Index.
1939-40	127	119	131	126
1940-41	109	121	120	115
1941-42	124	147	154	137
1942-43	156	166	190	171
1943-44	269	185	252	237
1944-45	265	206	258	244
1945-46	273	210	240	245

In the case of certain individual commodities the rise may be attributed to scarcity of supply or to speculative influences for instance the acute shortage of food-stuffs and the rise in food prices could be partially due to cessation of imports of rice from Burma and exports of certain food-stuffs combined with hoarding and transport difficulties in the country. But it cannot be ignored that the general increase in prices is closely related with the expansion of currency. The following indices indicates this close association.

July, 1930=100.

	1940	1942	1943	1944	1945	1946
Notes in Circulation	132	204	356	505	613	705
Wholesale Prices	125	154	258	299	301	295

It must be now clear that internally the rupee has depreciated very much.

*Question 4*—Examine the relations of the Reserve Bank of India with the Indian Money Market

*Answer*—See answer to Question No 5, Economics, 1940

*Question 5*—What are forward transactions on a stock exchange? Would you regulate them? Give reasons

*Answer*.—See Answer to Question No 7, Economics, 1938.

It must be admitted that though the advantages of forward trading cannot be overlooked sufficiently strong measures are necessary to keep speculation within limits and not allow it to degenerate into a gambling in differences. Such a regulation help infuse confidence among investors as prevention of wild speculation and gambling on the Stock Exchange will bring about healthier markets and avert frequent and wide fluctuation in values which invariably prove to be sources of anxiety to genuine investors. Admittedly, in the initial stages attack on unhealthy speculation might produce adverse reactions in values but such movements would prove to be a temporary phase. It is, however, felt that no restriction should be placed on trade nor should speculation be banned. To talk of abolishing speculation by legislation forward trading in shares is to cry for the moon. That will not be possible so long as private enterprise is allowed to function as at present and so long as the moral tone of the public continues to be what it is. As the Morrison Committee has rightly pointed out the aim of Government should be to check speculation and not try to stop it "which will be impossible". If the Government accepts this view it should not talk in terms of abolition of forward trading but only of regulation thereof. A reasonable measure of healthy speculation has many advantages to investors. If no scope is provided for healthy forward trading in shares the scope for free marketability of one's holding will be injurious to the interest of investors themselves.

The magnitude of the task cannot be under-rated. But it is quite possible to succeed if we decide upon a system of compulsory margins both on all sales and purchases and also abolish blank transfers entirely. If both these measures are to prove a success, they require, as a necessary corollary the removal of distinction between cash and forward scrips, as

prevailing on some Stock Exchanges, Bombay particularly, and the establishment of a Clearing House to each Stock House.

*Question 6* —Discuss the effects of World War II on Indian Trade.

*Answer* —See Answer to Question No. 4, Economics, 1947.

*Question 7.*—Suggest measures to increase the industrial production of India.

*Answer* —Although India has been ranked as one of the eight industrial countries in the world by reason of the size of industrial raw materials it consumes and the basic commodities it manufactures, the country is certainly backward when compared with other highly industrialised countries like the U.S.A., the U.K. or Canada. This is evident, to some extent, from a comparison of the pre-war *per capita* income from industries in these countries. While it has been as low as Rs. 8 in the case of India, the *per capita* income from industries is Rs. 412 in the U.K., Rs. 470 in Canada and Rs. 721 in the U.S.A.

Besides being thus industrially backward, India is also under-developed. The fact that the country is predominantly agricultural, with 67.2 per cent. of its people subsisting on land, and the fact that the bulk of the country's export consists of agricultural commodities and other raw materials are a proof that the country has not reached a stage where it can be in a position to utilise its economic resources by its own industries. There is a big gap between what the country is now producing and its capacity to produce.

In addition to being industrially both undeveloped and under-developed, India has been witnessing in recent years a gradual deterioration in its industrial production. This is indicated by the index number of industrial production. The index number, with 100 for 1938-39 as base, which recorded a rise of 191 to 1191 during the war period, dropped to 1091 in 1945-46 to be followed by a further drop to 987 in the year 1946-47. This decline has been due to unsettled labour conditions, civil disturbances, transport bottlenecks, shortages of raw materials, and lack of plant and machinery for replacing worn out units and for expanding existing ones, let alone for starting new units. To a major extent, lack of technical assistance has also been

responsible for restricting expansion of industrial activity over a large field in the country.

It is therefore necessary that the country should engage seriously with the work of devising ways and means not only of arresting the setback in the existing industrial units as noted above but also of exploring possibilities of expanding the scope of industrialization. The following are a few of the steps adoption of which can accelerate industrial development.

(1) *Protection as a means of industrial development* — One of the common means adopted for the development of industries is the protective tariff, i.e., imposing import duties on foreign goods for a definite period, ensuring the home industries freedom from foreign competition for that period and attracting indigenous enterprise into industrial field. America and England developed their industries under the shelter of high tariff walls. Protection is an accepted method to bring about an industrial development.

(2) *Scientific Management*. — But protection alone cannot build solid industrial foundation in India. The industrialists themselves must exert and adopt scientific management. Its principles should be applied to the location and organisation of factories and offices to the selection, training and organisation of the personnel, to the utilization of best possible methods and equipment so as to achieve the maximum possible efficiency of every part of the industrial machine at the lowest cost possible.

(3) *Rationalisation* — The term rationalization is generally applied to the re-organisation of industry. It involves amalgamation and modernisation with the object of adopting the most economical and efficient methods of production and eliminating waste of every kind particularly waste of material, waste of labour and waste of mechanical power.

(4) *Industrial Planning* — We require 'purposeful planning' of the entire industrial field. Our natural resources are vast and potentialities great but economically we are at the bottom of the world. Only a revolutionary economic policy and a radical re organisation of industry can bring out what India is capable of.

Planned economy has been defined as a 'scheme of economic organisation in which individual and separate plants,



enterprises and industries are treated as co-ordinate units of one single system for the purpose of utilizing all available resources to achieve the maximum satisfaction of the people's needs within a given time. What scientific management does for a particular unit of industry and rationalization for all the units in the industry, industrial planning should do for all the industries put together.

*Some other Handicaps.*—The chief impediments to industrial progress may be listed under six heads—raw materials, transport, inadequacy of capital and credit facilities, lack of enterprise and industrial experience, inadequate knowledge of our resources, lack of organised cooperative effort, the absence of driving and directing force from the State, and last but not the least industrial unrest.

We must carefully study all these problems and then handle them boldly. We should turn to the improvement of all the main requisites of industrial development viz. men, money, material, market, motive power etc. Out of our human material we must produce, through scientific training and technical and general education, captains of industry, efficient managers and highly skilled, healthy, resourceful, intelligent and responsible workers. Capital resources of the country must be effectively mobilized by means of an efficient system of banking. The quality and quantity of our raw materials must be improved through the development of agriculture on modern scientific lines. Our markets must be reserved for our own goods and marketing organization must be improved and made more efficient. Further, the hydro-electric resources of the country should be fully tapped so that energy at cheap rates is made available to our industries. Improvement of the means of communication and transportation, sympathetic stores purchase and railway rates policy, provision of industrial education and research, collection and dissemination of industrial intelligence and suitable machinery for exploring industrial possibilities and doing the necessary preliminary prospecting work, are some of the other essentials which need careful attention.

*Question 8.*—Are you in favour of nationalization of large scale industries in India? Give reasons for your answer.

*Answer*—Mr. Emanuel Shinwell, War Minister and Chairman of the Labour Party National Executive in England has recently become a sharp critic of the policy of nationalization of industries adopted by the British Government. It does not mean that his enthusiasm for

nationalization has waned or he wants to go back to private enterprise. He has been complaining that the Labour Party had the nationalization of all the key industries as the principal plan of its economic programme for the past many decades and yet it had not prepared a detailed plan and consequently, when some industries like coal and transport were nationalized many difficulties had to be faced. He has further emphasized that mere nationalization without active partnership of the workers in the management does not amount to Socialization. Both these criticisms deserve to be seriously considered in this country by the advocates of nationalization. It is hastily assumed that all that is needed for nationalization is to make the management of industry a Government agency. Private enterprise is guided and controlled by the motive for profit. It is narrow test and is often detrimental to wider public interest. But it is an effective check against waste and inefficiency. The private capitalist has to make the best possible use of his capital equipments and labour in order to make profits and if he does not do so, he has to pay a high penalty. But in a nationalized industry these checks and sanctions do not hold good. The managing staff are not judged by results and have to be afraid only of infringement of rules and orders. Overhead charges continue to increase disproportionately and labour expects more from a nationalized concern than from a private establishment. If the latter becomes unprofitable, the owner may close down and the workers may be thrown out of employment. In a State enterprise, however, deficits are not expected to have the same serious consequences and it is assumed that money will come from the public exchequer.

It is obvious that without a radical change in outlook on the part of workers and the Government nationalization may become a source of weakness rather than of strength. The tendency to treat national industry as if they are mere administrative departments must be resisted at all cost. The management of national industry must be judged by results and the inefficient and the incompetent should not be protected by service rules and guarantees of security. The workers also should realize that their wages will depend upon the production of commodities and supply of services at a reasonable cost to the consumer. As far as possible, piece work should be introduced and where it is not practicable the workers in nationalised industry should be provided with the same inducements as in private enterprise such as the offer of bonus for efficiency and high productivity.

It is desirable that maximum facilities should be given to the workers to participate in the evolution of policy and in the conduct of administration of high nationalized industry. This will not however lead to much useful result unless the workers have a higher standard of general education and can understand the economical, financial and technical problems of the industry. Any programme of large-scale nationalization depending upon illiterate and unskilled workers is bound to be a disastrous failure. It is, therefore, essential that nationalization of industry should be undertaken after careful preparation and after securing workers of higher qualities than are to be found in private industry. The hesitation of the British Labour Party to implement their policy of nationalization of steel industry is due to these conditions. The British steel industry is at present highly organised and is producing steel at the annual rate of 15 million tons. There is some fear that hasty nationalization may result in decreased production. The Governments in India are much less competent than the British Government to run nationalized industry. It is, therefore, suggested that the former should try to concentrate on a small and well-defined sector of industry for nationalization to start with so that when they have mastered the technique and evolved the new tests, technique, sanctions and inducements for running nationalised industry efficiently and economically, they may proceed to a progressive enlargement of this sector.

*Question 9.*—Write short notes on any four of the following:—

- (a) International Trade Organisation.
- (b) World Bank. (c) Nationalization of the Reserve Bank of India.
- (d) Deflation, (e) Exchange Control.

*Answer (a) International Trade Organization.*—No world monetary mechanism can work satisfactorily unless trading conditions are satisfactory. With the help of the I.M.F. (International Monetary Fund), temporary disequilibria in a country's balance of payments may be removed. But there may be fundamental causes of disequilibrium in operation, which may produce chronic instability and depression, leading to a fundamental derangement of a country's economy and flight of capital. The International Monetary Fund cannot deal with deep-seated maladies of national economies. They have their roots in work and trade, and must be the concern of a special organisation, the I.T.O.

The I.T.O. will have general supervision and control in all trade matters. It will also collect, analyse and publish information relating to the whole field of world trade. Its principal organs will be a conference of all members once a year, an Executive Board, consisting of 18 member countries, with the leading countries as permanent members, a commercial policy commission, a commission on business practices, a commodity commission and a secretariat. When this organisation has been brought into being, and begins to function, the control of world trade will be virtually exercised by a few leading countries. But the I.T.O. will find the greatest difficulty in harmonising the conflicting claims, policies and demands of member countries.

(b) *World Bank*.—At the Bretton Woods Conference it was decided to set up the International Bank for Reconstruction and Development in addition to the International Monetary Fund.

The primary purpose of the Bank is, as its full title indicates, to assist in the reconstruction and development of member countries, and this objective is to be achieved "by facilitating the investment of capital for productive purposes". It is intended to serve as an essential adjunct to the Monetary Fund, and in particular to ensure a high and stable level of international investment with a view to promoting the maintenance of a high level of international trade and thus of production and employment.

The Bank is designed, in the first instance, to promote foreign investment by guaranteeing in whole or in part loans made by private investors through the usual investment channels. It is only when such guaranteed loans are for one reason or another not available on reasonable terms or in adequate amounts, that the Bank will really be called upon to supplement private investment by making loans or participating in loans and other investments for productive purposes out of its own paid-up capital and general reserves or out of funds raised or borrowed by it.

(c) *Nationalization of the Reserve Bank*.—The question whether the Central Banking institution should be state-owned or be a shareholders' bank completely free from political influence is an old one. The pros and cons of both the systems were thoroughly thrashed out during the years 1927-1934 and it was finally decided that the Reserve Bank of India as it is constituted at present was preferable to a State-owned Central

Bank. Much has happened since then. It has now come to be realised (and this change in opinion has come with the change in the Government) that the Central Bank of a country can never be entrusted to private enterprise with the pivotal position that it occupies in the economic system of the country. There are, indeed, very few Central Banks which are not being directly controlled by the Government. Even the Bank of England and the Bank of France which had long traditions of independent existence have been completely nationalised. The United States Federal Reserve Board, the supreme financial institution in the country is nominated by the Government and is a part of the Government's administrative machinery. The nationalization of the Reserve Bank is in full conformity with the trend of political and economic thought all over the world. By virtue of the functions it performs and the powers it exercises, the Central Bank of a country must be an integral part of the machinery of the state through which the state can implement its plan of economic development. The Central Bank as a private institution can only exist in a country which still professes faith in the laissezfaire philosophy. But those countries which seek to develop their resources on a planned basis cannot permit the Central Banks to follow an independent policy dictated by the financial oligarchy which controls it. The Reserve Bank of India ought, therefore, to be a public corporation, publicly owned and controlled by the state. But a public corporation ought to be free from the day-to-day control or interference from Parliament or the Finance Department. It is essential that the directors of the bank should be men of wide financial and administrative experience, and of unimpeachable integrity. Everything depends upon the persons chosen to run the bank. We can ensure the success of the Central Bank by building up the right traditions rather than by statutory provision. The directors ought to be as widely representative of the various economic interests in the country as possible.

(d) *Deflation* — See answer to Question No. 9 (c), Economics, 1946.

(e) *Exchange Control* — See answer to Question No. 9 (b), Economics, 1942.

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## HIGHER ACCOUNTANCY—PART II.

1944

*Question 1.*—Wincent and Leopold are in Partnership as Pipe Manufacturers, the former taking  $\frac{2}{3}$  and the latter  $\frac{1}{3}$  of Profits. They also rent and work a retail shop. The shop manager sends in weekly returns of all transactions, and these are duly incorporated in the books of the Head Office. Prepare Trading Account showing the working results of the Shop, also Trading, Profit and Loss Accounts and Balance Sheet for the year ended 28th February, 1944. Stocks at Factory Rs 3,105, at Shop Rs. 470. The goods supplied by the Factory to the shop were priced out at Rs. 4,199 cost price. The Adjustments to be effected are:—(a) Interest on Capital at 5%, (b) Reserve for Rent Rates etc Account (Factory) for Rent accrued due 28th February, 1944, Rs. 78; (shop) for Rent accrued due for 2 months on the basis of the Annual Rent of Rs 360, (c) Legal fees payable Rs. 36; (d) Manager is entitled to commission at 2% on the Gross Profit realised by the Shop, (e) Plant and Machinery to be depreciated at 10% and Fixtures and Fittings at 5%; (f) Provision for Bad and Doubtful Debts at  $2\frac{1}{2}\%$ .

Debit Balances.	Ra.	Credit Balances.	Rs.
Plant and Machinery	3,280	Vincent's Capital Account	6,200
Fixtures and Fittings (Factory)	620	Leopold's Capital Account	3,500
Purchases	11,780	Sales (Factory)	19,353
Manufacturing Wages	6,433	Sales (Shop)	7,538
Manufacturing Expenses	891	Sundry Creditors	2,428
Rent Rates and Insurance (Factory).	360	Discount (Factory)	282
Rent Rates and Insurance (Shop)	423	Reserve for Bad Debts as on 1st March, 1943	74
Stock on 1st March 1943 (Factory)	3,828	Bills Payable	78
Stock on 1st March 1943 (Shop)	747		
Cash Purchases (Shop)	62		
Travellers' Commission (Factory)	152		
Office Salaries (Factory)	280		
Legal Fees (Factory)	41		

Debit Balances.	Rs.	Credit Balances.	Rs.
Office Expenses (Factory)	395		
Bad Debts (Factory)	8		
Sundry Debtors	2,520		
Furniture, Fixtures and Fittings (Shop)	980		
Bills Receivable	2,000		
Salaries of Manager and Shop Assistants	266		
Wincent's Drawings	1,212		
Leopold's Drawings	606		
Cash and Bank	2,512		
Cash at Shop	50		
Cash at Factory	7	214	
Total Rs	39,453	Total Rs.	39,453



Answer:—

Wincent and Leopold  
TRADING ACCOUNT  
For the year ended 28th February, 1943.

	Factory	Shop	Total		Factory	Shop	Total
To Stock	Rs. 3,828	Rs. 747	Rs. 4,575	By Sales	Rs. 9,363	Rs. 7,538	Rs. 26,891
" Purchases	11,780	...	11,780	" Goods supplied to Shop	4,199	...	4,199
" Cash Purchases	...	62	62	" Stock	3,105	470	3,575
" Goods received from Factory	...	4,199	4,199				
" Manufacturing Wages	6,433	...	6,433				
" Manufacturing Expenses	891	...	891				
" Gross Profit carried to P. & L Account.	3,725	3,000	5,725				
Total Rs.	26,657	8,008	34,665	Total Rs.	26,657	8,008	34,665



## BALANCE SHEET

As at 28th February, 1943.

LIABILITIES				Rs.	Rs	ASSETS				Rs.	Rs.
Sundry Creditors :—				2,428		Cash.—	...	7			
On Open Accounts				78		At Factory	...	50			
Bills Payable				...		At Shop	...	2,512			2,569
Outstanding				234	2,740	At Bank	...				
Capital Accounts :—											
Wincnet :—						Bills Receivable	...				
Balance, 1st March, 1942				Rs. 6,200		Sundry Debtors	...	2,520			
Add Interest 5%				310		Less Reserve for Doubtful Debts.	...	63			2,457
Add Profit 2/3rds share				2,644		Stock :—					
						Factory	...	3,105			
Less Drawings				...	7,942	Shop	...	470			3,575
Leopold :—						Furniture & Fixtures .—	Rs.				
Balance, 1st March, 1942				3,500		Factory	620				
Add Interest 5%				175		Less Depreciation 5%	31	589			
Add Profits-1/3rd share				1,322							
						Shop	980				
Less Drawings				...	4,391	Less Depreciation 5%	49	931			1,520
						Plant & Machinery	...	3,280			
						Less Depreciation 10%	...	328			2,952
Total Rs.				...	15,073	Total Rs	...				15,073

**Question 2.**—

Jannohmed, was the holder of 20 shares of Rs. 10 each in the Khoja Kolsa Mine Co., Ltd., upon which Rs. 5 per share had been called up, but he had only paid Re. 1 per share as Application deposit thereon. The Company forfeited the shares and afterwards sold them to Dostmohmed credited with Rs. 5 per share paid, for Rs. 90.

How should the Forfeiture and Re-issue be recorded in the Company's Books?

*Answer* —

### JOURNAL ENTRIES

	L F		Rs.	Rs.
Share Capital Account	...	...		
To Forfeited Shares Account	...	Dr	100	20
" Call Account	...	...		80
(Being the forfeiture of 20 shares of Rs. 10 each Rs. 5 called up, for non-payment of Rs. 4 per share as per Minute dated . . . . .)				
Bank Account	...	Dr		
Forfeited Shares Account	...	...	90	
To Share Capital Account	...	...	10	
(Being the re-issue of 20 forfeited shares, Rs. 5 per share called up for Rs. 90).				100

Since the shares have been re-issued, the Share Capital will appear in the Balance Sheet at the called up figure. The credit balance of Forfeited Shares Account Rs. 10 will appear as a separate item on the Liabilities Side. It is not advisable to transfer this amount to P. & L. Account, although a Company may do so unless forbidden by its Articles.

## Question 3 —

A Company having a Share Capital of Rs. 5,00,000 divided into 500 shares of Rs. 1,000 each, when are quoted in the Share Bazar at Rs. 2,700 each, distributes a bonus out of Reserve Fund at the rate of 60 per cent. of the Original Capital by issuing to the holder of every share a Coupon for Rs. 250 (fully paid share) in full settlement of the Bonus. Pass the necessary entries.

SOLVER. —

## JOURNAL ENTRIES

L. F		Rs.	Rs.
Reserved Fund Account	...	Dr.	3,00,000
To Bonus Account	...	...	
(Being a bonus 60% on the original Capital declared to the shareholders as per Shareholders' Minute dated.....)			
Bonus Account	...	Dr.	1,25,000
To Share Capital Account	...	...	1,75,000
To Share Premium Account	...	...	
(Being the issue of 500 Share Coupons of Rs. 250 each at a premium of Rs 350 per share to the shareholders in full satisfaction of the payment of Bonus)			

## Question 4—

A, B and C are in Partnership sharing profits and losses in the proportion of  $\frac{2}{5}$ ,  $\frac{2}{5}$  and  $\frac{1}{5}$ . They dissolve the Partnership and B continued the business by taking over the goodwill of the Firm at Rs 5,000. Their Balance Sheet is as follows—

Liabilities	Rs.	Assets.	Rs.
Sundry Creditors	...	Cash in Hand	700
Bills Payable	..	Cash at Bank	3,000
Capitals.—		Bills Receivable	4,500
A	17,000	Book Debts	9,800
B	20,000	Investments	6,300
C	9,600	Stock-in-Trade	12,300
		Office Motor Car	6,500
		Machinery and Plant	7,500
		Goodwill	3,000
	Total ..	Total	53,600

A takes over Investments at a value of Rs. 5,500 and the Office Motor Car for Rs. 7,000. The other Assets and Liabilities are taken over by B on revaluation agreed upon by all the partners, as follows—

Stock at Rs 10,500 and Machinery and Plant at Rs 8,500. The Bills Receivable and Book Debts are taken over by him at their book values on A and C agreeing to keep with him

an amount of Rs 500 each as guarantee to cover any loss that he may sustain on realising these Assets. A and C are paid out on B's bringing in the necessary cash.

Show necessary Ledger Accounts on closing the books of the Partnership and also show the Balance Sheet of B.

Answer :—

### A's CAPITAL ACCOUNT.

	Rs.		Rs.
To Realization Account —	Rs.	By Balance b/fd.	...
Investments	5,500	„ Realization A/c.—Profit	...
Motor Car	7,000		17,000
			240
To B's Capital A/c.—guarantee	..		
„ Bank	...		
Total Rs		Total Rs.	...
			17,240

## B's CAPITAL ACCOUNT

	Rs.		Rs.
To Realization Account --	Rs.	By Balance b/fd.	20,000
Stock	10,500	" Realization Account --	Rs. ...
Machinery	8,200	" Sundry Creditors	4,200
Bills Receivable	4,500	" Bills Payable	2,800
Book Debts	9,800		---
Goodwill	5,000	" Realization A/c. -- Profit	240
		" A's Capital -- Guarantee	500
		" C's Capital -- Guarantee	500
		" Bank	9,760
Total Rs	38,000	Total Rs	38,000

## C's CAPITAL ACCOUNT

	Rs.		Rs.
To B's Capital -- Guarantee	500	By Balance b/fd.	9,600
" Bank	9,220	" Realization A/c -- Profit	120
		Total Rs.	9,720
Total Rs	9,720		



## REALIZATION ACCOUNT.

To Sundry Assets :— Bills Receivable Book Debts Investments — Stock Motor Car Machinery Goodwill	Rs. 4,500 9,800 6,300 12,300 6,500 7,500 3,000	Rs.	By Sundry Liabilities :— Sundry Creditors Bills Payable	Rs. 4,200 2,800	Rs.
—	—	Rs.	A's Capital A/c :— Investments Motor Car	5,500 7,000	7,000
To B's Capital Account— Sundry Creditors Bills Payable	4,200 2,800	Rs.	B's Capital A/c.— Stock Machinery Bills Receivable Book Debts Goodwill	10,500 8,200 4,500 9,800 5,000	12,500
To Capital Accounts — A 2/5ths B 2/5ths C 1/5ths	240 240 120	Rs.	—	—	38,000
Total Rs.	57,500	Rs.	Total Rs.	...	57,500

## BANK ACCOUNT

	Rs.	By A's Capital " C's Capital	Rs.
To Balance b/fd.	3,000	...	4,240
" Cash-Transfer	700	...	9,220
" B's Capital	9,760	...	
Total Rs.	13,460	Total Rs.	13,460

## BALANCE SHEET OF B.

As at ..... /

	Rs.	Bills Receivable Book Debts Stock Machinery Goodwill	Rs.
Bills Payable	2,800		4,500
Sundry Creditors	4,200		9,800
Guarantee Accounts			10,500
A	500		8,200
C	500		5,000
B's Capital	30,000		
Total Rs.	38,000	Total Rs.	38,000

## Question 5 —

Mr. Orthodox, in the retail trade, has not kept proper books of accounts and on having to render accounts for Income-tax purposes, instructs you to ascertain the Profit or Loss for the year ended 31st March, 1914, and to prepare a statement of affairs as at that date, and furnishes you the following particulars :—

	1-4-1913.	31-3-1914.
Stock-in-Trade	...	18,700
Sundry Creditors	...	15,400
Sundry Debtors	...	11,200
Cash in Hand	...	250
Bank Overdraft	...	20,200
Bills Receivable	...	15,050
Fixtures and Fittings	...	1,500
Motor Delivery Van	...	1,900

The Drawings during the year amounted to Rs 2,600. Depreciate Fixture and Fittings by 10% and Write Rs 300 off the Motor Delivery Van. As regards the Debtors, it is ascertained that Rs. 500 are irrecoverable and a further reserve of 5% should be made. A reserve Rs. 700 in respect of Bills Receivable.

Answer —

## STATEMENT OF AFFAIRS

As at 1st July, 1942.

LIABILITIES	Rs.	ASSETS	Rs.
Bank Overdraft	20,200	Cash in hand	250
Sundry Creditors	15,400	Bills Receivable	15,050
Capital—being excess of assets over liabilities	11,000	Sundry Debtors	11,200
		Stock-in-trade	16,700
		Fixtures, Fittings, etc.	1,500
		Motor Van	1,900
Total Rs.	46,600	Total Rs.	46,600

## STATEMENT OF ASSETS AND LIABILITIES

As on 30th June, 1943.

LIABILITIES	Rs.	ASSETS	Rs.
Bank Overdraft	19,400	Cash in hand	1,200
Sundry Creditors	14,000	Bills Receivable	14,200
Capital—being excess of assets over liabilities	14,400	Sundry Debtors	10,500
		Stock-in-trade	18,500
		Fixtures, Fittings, etc.	1,500
		Motor Van	1,000
Total Rs.	47,800	Total Rs.	47,800

## STATEMENT OF PROFIT AND LOSS

For the year ended 30th June, 1943.

	Rs.	Rs.
Capital at close as per Statement of Assets & Liabilities	...	14,400
Add Drawings during the year	...	2,600
Less Capital at start as per Statement of Affairs as at 1st July, 1942	...	17,000
Profit—being the excess of closing Capital over the opening one	...	11,000
Less:—		Rs. 6,000
Depreciation on Fixture etc.	...	150
" Motor Van	...	300
Bad Debts	...	300
Reserve for Doubtful Debts —	Rs.	
On Debtors	500	
On Bills Receivable	700	
	1,200	2,150
	Total Rs.	3,850



*Question 6 .—*

The Trial Balance of the Allies Banking Corporation, Limited, as on 31st December, 1943, stood as follows :—

	Rs		Rs.
Paid up Capital	10,00,000	Fixed Deposits	20,00,000
Local Bills Discounted	9,00,000	Profit & Loss Account Credit Balance	1,10,000
Reserve Fund	3,85,000	Stamps & Stationery	5,000
Cash Credits & Overdraft	14,00,000	Cash-in-hand	2,50,000
Unclaimed Dividends	5,000	Cash at Banks	6,50,000
Loans	23,00,000	Investments (at Cost)	4,75,000
Current & Savings Depo- sits	25,00,000		
Furniture	20,000		

Out of the total debts, debts for Rs 2,85,000 were considered doubtful and the balance was considered good. Out of the debts considered good, debts amounting to Rs. 24,00,000 were fully secured and for debts amounting to Rs. 4,00,000 (including Rs. 1,15,000 due by a Director) the Bank held personal securities of one or more persons over and above the personal securities of the Debtors, and for the balance the Bank held no other security than the personal security of the Debtors

The Directors require the Bank's Investments to be shown in the Balance Sheet at Market Value on 31st December, 1943, which is Rs. 5,25,000.

Prepare the Balance Sheet of the Bank as on 31st December, 1943, in the proper form.

**THE ALLIES BANKING CORPORATION LIMITED**  
**BALANCE SHEET**

As at 31st December, 1943

Answer :—

CAPITAL & LIABILITIES		PROPERTY & ASSETS	
Authorised Capital — shares of Rs	each	Cash Credits & Overdrafts	Rs
Issued & Subscribed Capital — shares of Rs	each	Loans	14,00,000
Paid-up Capital . each	shares of Rs.	Local Bills Discounted	23,00,000
Reserve Fund	..	Particulars as required by the Act —	9,00,000
Investment Fluctuation Fund	..	1. Debts considered good and in respect of which the Bank is fully secured	Rs. 24,00,000
Fixed Deposits	..	2 Debts considered good and secured by personal liability of one or more parties in addition to the personal security of debtors	2,85,000
Current & Savings Deposits	..	3 Debts considered good as unsecured, except by the personal security of the Debtors	15,15,000
Unclaimed Dividends	..	4 Debts due by Directors and other Officers of the Bank	1,15,000
Profit & Loss A/c—Balance	..	5 Debts considered Doubtful	2,85,000
			46,00,000
		Furniture	20,000
		Stamps and Stationery	5,000
		Investments at Market Value	5,25,000
		Cash in hand	2,50,000
		Cash at Bank on Current A/c	6,50,000
		Total Rs	60,50,000



**Question 7:—**

Mr Broke filed his petition on 31st December, 1943, and his statement of Affairs was composed of the following figures:—

	Rs.
Creditors unsecured	75,000
Creditors partly secured by lien on Shares	40,000
Creditors fully secured by lien on Stock	100
Mortgage on Mills	10,000
Creditors payable in full (Preferential)	3,000
Liability on Bills Receivable Discounted (Estimated to rank Rs. 3,500)	7,000
Book Debts, good	20,000
Book Debts Doubtful and Bad (estimated to produce Rs. 2,000)	10,000
Consignments, good	5,000
Stock (estimated to realise Rs. 40,000)	60,000
Shares (cost and estimated to realise)	16,000
Cash at Bankers	100
Bills of Exchange	1,400
Mill of the Value of	11,000
Machinery (estimated to realise Rs. 12,000)	15,000
Fixtures (estimated to realise Rs. 1,500)	3,000
Cottages (estimated to realise Rs. 3,000)	3,500

On 1st January, 1938, he had a Capital of Rs. 50,000. Profits of Rs. 20,500 were altogether made up to 31st December, 1943, after allowing Interest on Capital Rs. 10,000. and total withdrawals amounted to Rs. 63,600.

Prepare the statement of Affairs and Deficiency Account.

*Answer.*— DEFICIENCY ACCOUNT OF MR. BROKE.

From 1st January ..... to 31st December.....

	Rs.		Rs.
Excess of Assets over Liabilities on 1st January.....	50,000	Bad Debts as per List (I)	8,000
Profits made in the six years	20,500	Expenses incurred since 1st January other than usual Trade Expenses, viz. Household Expenses.	63,600
Interest on Capital	10,000	Loss on Realising —	20,000
Deficiency as per Statement of Affairs	19,600	Stock	13,000
		Machinery	2,500
		Fixtures	500
		Cottages	3,500
		Bills Receivable discounted	1,00,100
			Rs.
			1,00,100

## STATEMENT OF AFFAIRS OF MR. BROKE.

As on 31st December.....

Gross Liabilities.	Liabilities (as stated and estimated by the Debtor)	Expected to rank	Assets (as stated and estimated by the Debtor)	Estimated to Produce
Rs.	Rs.	Rs.	Rs.	Rs.
75,000	Unsecured Creditors as per Last (A)	75,000	Property as per List (H):—	100
10,100	Fully secured Creditors as per List (B)	Rs. 10,100	Cash at Bankers	5,000
	Estimated value of Securities	11,000	Consignments, Good	39,900
	Surplus carried to contra	1,000	Stock	12,000
	Partly secured Creditors as per List (C)	40,000	Machinery	1,500
			Fixtures	3,000
			Cottages	61,500
			Total as per List (H)	
			Book Debts as per List (I)	20,000
			Good	

Gross Liabilities.	Liabilities (as stated and estimated by the Debtor)	Expec- ted to rank.	Assets (as stated and estimated by the Debtor)	Estimated to Produce
Rs	Rs.	Rs.	Rs.	Rs
	Less estimated value of Securities	24,000	Doubtful and Bad	2,000
7,000	Liabilities on Bills discounted as per List (D)	3,500	Estimated to produce Bills of Exchange as per List (J)	1,400
3,000	Preferential Creditors as per Lists (F) & (G) Deducted contra		Surplus of Securities in the hands of Creditors fully secured (per contra)	1,000
			Deduct Preferential Creditors per contra	85,900
			Deficiency as explained in State- ment (K)	3,000
				82,900
				19,600
1,36,100	Rs.	Rs.		Rs.
		1,02,500		1,02,500



Resolutions have been passed appropriating this profit as follows —

Rs 2,00,000 to Reserve Account

3 per cent Depreciation on Freehold Premises

10 per cent Bonus on the year's salaries of Rs 80,000

5 per cent Bonus on the year's wages of Rs. 7,50,000

5 per cent Sinking Fund on Leasehold Property.

Rs 10,000 to Directors' Special Remuneration.

10 per cent Dividend for the year Free of Tax

Balance to be carried forward.

Make the necessary Journal Entry, prepare a Profit and Loss Appropriation Account and revise the Balance Sheet.

Answer —

### JOURNAL ENTRIES

	L. F.	Rs.	Rs.
Profit and Loss Appropriation Account	Dr		
To Reserve Account		8,60,500	2,00,000
" Freehold Premises Account			30,000
" Bonus to Staff Account			45,500
" Sinking Fund Account			75,000
" Directors' Special Fees Account			10,000
" Ordinary Share Dividend Account			5,00,000
(Being the Appropriation of profits as per Resolutions passed at the General Meeting dated .. )			

## PROFIT &amp; LOSS APPROPRIATION ACCOUNT.

1932 Sep. 29		Rs.	1943 Sep. 29		Rs.
	By Reserve Account	2,00,000		By Balance from last period.	1,58,800
	" Freehold Promises A/c.	30,000		" Profit this year as per Profit & Loss Account	8,80,400
	" Bonus to Staff A/c.	45,500			
	" Sinking Fund for Leasehold Property	75,000			
	" Directors' Special Fees Account	10,000			
	" Ordinary Share Dividend Account	5,00,000			
	" Balance carried forward	1,76,700			
		Rs. 10,37,200			Rs. 10,37,200

**A. B. Co., Ltd.**  
**BALANCE SHEET.**  
**As at 30th September, 1943**

CAPITAL & LIABILITIES	Rs.
Authorised Capital — 50,000 Ordinary Shares of Rs 100 each	50,00,000
Issued Capital — 50,000 Ordinary Shares of Rs. 100 each, fully paid	50,00,000
20,000 Debentures of Rs. 100 each	20,00,000
Reserve A/c.—Balance	5,00,000
Add Further amount set aside	2,00,000
Sinking Fund (Leaseholders)— Balance	90,000
Add further Provision made	75,000
Sundry Creditors — On Open Accounts	8,50,000
Outstanding for Bonus, Dividend & Directors' Special Fee	5,55,500
Profit & Loss Appropriation A/c.—Balance	1,76,700
	<u>94,47,300</u>
	Rs.

  

PROPERTY & ASSETS	Rs.
Freehold Factory & Works	10,00,000
Less Depreciation	<u>30,000</u>
Leaseholds	9,70,000
Plant and Machinery	15,00,000
Motors and Motor Lorries	25,00,000
Horses, Carts Harness	95,000
Stock	57,200
Work-in-progress	3,20,000
Sundry Debtors	9,00,000
Cash —	23,00,000
At Bank on Current A/c	2,05,000
" " " Deposit	<u>6,00,000</u>
	8,05,7000
	Rs.



**Question 2.**—The Air Associates Limited re-build and re-equip part of their works at a cost of Rs. 50,000. The part of the old works thus superseded cost Rs. 30,000. The capacity of the new works is double than that of the old. Rs. 2,000 is realised by the sale of old materials, and old materials valued at Rs. 1,000 are used in the reconstruction and included in the cost of Rs. 50,000 above mentioned. The cost of Labour and Materials is 10 per cent. higher now than when the old works were built.

Give the Journal Entries for recording the above transactions in the books of the Company, showing particularly what amount you consider should be charged the Capital Expenditure.

*Answer:—*

### JOURNAL ENTRIES

		L F.	Rs.	Rs
Works Account	Dr.		16,00	
Replacement Account			33,00	
To Bank				40,000
(Being the apportionment of the expenditure of Rs. 49,000 of which Rs. 33,000 is charged to Replacement Account, as the same represents the present cost of replacing old works which originally cost Rs. 30,000).				
Bank	Dr.		2,000	
To Replacement Account				2,000
(Being the amount realised on the sale of old materials).				
Works Account	Dr.		1,000	
To Replacement Account				1 00
(Being the value of old materials utilised in reconstruction).				

As a result of the above entries, Rs 17,000 of the cost of reconstruction is capitalised, bringing the total amount standing to the debit of Works Account to Rs. 47,000. The Replacement Account will be further credited with any Depreciation Fund standing in the books in respect of the old works and the balance then standing on that Account will be transferred to Reserve Account. Thus only the cost of extension has been charged to Capital, the extra cost of replacement due to rise in labour and materials being charged to Revenue.

As capacity of the new works has been increased doubly, it will not be unsound or unwise to charge to capital a further amount so as to bring up the Works Account to double the value of the old works, although the former method is safer and more conservative.

*Question 3.*—While closing the books of a bank on 31st December, 1943, you find in the Loan Ledger an unsecured balance of Rs. 2,00,000 in the account of a Sattawalla whose financial condition is reported to you as doubtful and bad. Interest on the same account amounted to Rs. 20,000 during the year. How would you deal with this item of interest in 1943 Accounts?

During the year 1944, the Bank accepts 12 annas in the rupee on account of the total debt to 31st December, 1943.

Prepare the necessary accounts showing the ultimate effect of the transaction in the 1944 books of Accounts

*Answer:—*

## LOANS LEDGER

Mr. Sattawalla's Account.

	Rs.		Rs.
31-12-43 To Balance	2,00,000	31-12-43 By balance c/d.	2,20,000
„ Interest suspense A/c	20,000		2,20,000
	2,20,000	31-12-44 By Cash	1,65,000
31-12-43 To Balance	2,20,000	„ Interest suspense A/c	5,000
	2,20,000	„ Bad Debts A/c	50,000
			2,20,000

## INTEREST SUSPENSE ACCOUNT.

	Rs.		Rs.
31-12-43 To Balance c/d	20,000	31-12-43 By Mr. Sattawalla's A/c	20,000
31-12-44 To Mr. Sattawalla's A/c	5,000	31-12-43 By balance b/d.	20,000
To Interest A/c	15,000		
	20,000		20,000

*Question 4* —X, Y, and Z, carried on business in partnership, profits being divisible to X  $\frac{1}{2}$ , to Y  $\frac{1}{3}$ ; and to Z  $\frac{1}{6}$ .

The balance Sheet on 31st December, 1944, showed their capitals to be—

X: Rs. 10,400, Y: Rs. 5,000, Z: Rs. 3,000.

On 28th February, 1945, X died and you are instructed to prepare an account for presentation to his executors having regard to the following facts:—

- (1) The firm had insured the partners' lives severally, X for Rs. 9,000, Y for Rs. 4,800 and Z for Rs. 2,400. The premiums have been charged to Profit and Loss Account and the surrender value on 28th February, 1945, amounted in each case to one-fourth of the sum assured
- (2) Capital carried Interest at 5% per annum.
- (3) X's Drawings from 1st January, 1945, to the date of his death amounted to Rs. 1,200.
- (4) X's share of profits for the portion of the current financial year for which he lived was to be taken at the sum calculated on the average of the last 3 completed years and goodwill was to be raised on the basis of 2 years' purchase of the Average Profit of those 3 years

The annual profits were Rs. 9,200, Rs. 7,400 and Rs. 8,600 respectively.

Prepare the Account of the Executors of X (Deceased)

Answer —

#### THE EXECUTORS OF X (DECEASED).

	Rs.		Rs.
To Drawings		By Capital Account	
Account		Balance transferred	10,400-0-0
" Balance	1,200-0-0	" Interest on Capital	86-10-0
C/d.	23,786-10-8	" Profits for 2 months $\frac{1}{2}$ Share	700-0-0
		" Goodwill A/c — $\frac{1}{2}$ Share	8,400-0-0
		" Policy Account — $\frac{1}{2}$ Share	4,500-0-0
		" $\frac{1}{2}$ Share in Surrender Value of other policies	900-0-0
			<hr/>
	24,986-10-8		24,986-10-8
		By Balance b/d.	23,786-10-8

## JOURNAL ENTRIES.

	L. F	Rs.	Rs.
Interest on Capital Account Dr.		86-10-8	
To the Executors of X (deceased)			86-10-8
(Being interest on X's Capital for two months at 5%).			
Profit & Loss Account Dr.		700-0-0	
To the Executors of X (deceased)			700-0-0
(Being $\frac{1}{2}$ share of proportionate profits calculated on the average of the last three completed years).			
Goodwill Account Dr.		8,400-0-0	
To the Executors of X (deceased)			8,400-0-0
(Being $\frac{1}{2}$ share of Goodwill calculated upon two years' purchase of the average profits of three years).			
Bank Dr.		9,000-0-0	9,000-0-0
To Policy Account (Being amount received on A's Policy on his death).			
Policy Account Dr.		4,500-0-0	
To the Executors of X (deceased)			4,500-0-0
(Being $\frac{1}{2}$ share in the policy due, viz, of X).			
Surrender Value of Policies Account Dr.		900-0-0	
To the Executors of A (deceased)			900-0-0
(Being $\frac{1}{2}$ share in the surrender values of other policies, viz, of Y's & Z's)			
The Executors of X (deceased) Account Dr.		1,200-0-0	
To X's Drawings Account (Being the Drawings for the current period charged to the former account).			1,200-0-0

*Note:*—The entry for transfer of share in X's Policy to Y and Z is not given, as Journal entries affecting X's Account only are required.

**Question 5 :—**  
 Prepare Revenue Account and Balance Sheet of the Fire Fire Insurance Co., Ltd., on 31st December, 1944, from the following :—

	Ra.	Ra.
Premiums	69,000	7,70,000
Re-insurance premiums paid	4,80,000	
Losses by fire		60,000
Losses recovered under re-insurance contracts		20,000
Interest and Dividends	6,500	
Income-tax on interest and dividends	1,20,000	
Expenses of management	1,19,000	
Commission	11,000	
Printing, stamp, stationery		2,50,000
Capital		2,80,000
Fire and General Reserve Fund		63,000
Outstanding Fire Losses		6,500
Unclaimed Dividends		3,500
Profit and Loss Appropriation Account Balance as on 1st January, 1944	12,500	
Interim dividend paid to shareholders	1,10,000	
Mortgages in and outside India	2,03,000	
Indian, Colonial and Foreign Securities	2,00,000	
Deposit with Reserve Bank of India	6,000	
Outstanding Interest and Dividends	1,500	
Outstanding Premiums	10,500	
Cash at Bank	1,05,000	
Agents' and Branch Office Balances	14,53,000	14,53,000

Answer —

## The Fire Fire Insurance Co., Ltd.

## REVENUE ACCOUNT

For the year ended 31st December, 1943.

Rs.	Rs.	Rs.	Rs.
Losses by Fire	4,80,000	Premium	7,70,000
Less Losses Recoverable	60,000	Less Re-assurances	69,000
Expenses of Management		Interest and Dividends	13,500
Commission			
Foreign State Taxes			
Profit carried to Balance Sheet			
			7,14,500

## BALANCE SHEET

As at 31st December, 1943.

LIABILITIES	Rs.	ASSETS	Rs.
Capital Fire and General Reserve Fund	2,50,000	Mortgages within United Kingdom	1,00,000
Outstanding Fire Losses	2,80,000	" out of United Kingdom	10,000
Profit & Loss Appropriation	63,000	British Colonial and Foreign Securities	1,55,000
Account —	6,500	Railway Debentures and Stock	1,50,000
Balance last year	Rs. 3,500	Railway Preference Shares	33,000
Add Profit this year	44,500	Municipal and Country Council, etc. Loans	17,000
	48,000	Bank Deposits	20,000
Less Shareholders'		Deposits with Foreign Countries	17,000
Dividend paid		Deposits with United States Trustees	11,000
and payable	12,500	Agents' & Branch Office Balances	1,05,000
	35,500	Outstanding Interest & Dividend	5,000
		Outstanding Premiums	1,500
		Cash at Bank	10,500
	6,35,000		6,35,000



*Question 6.*—The Directors of Textiles Limited decided to replace entirely their plant which is now out of date. Having advertised for tenders for the new machinery they require, they accept that sent in by Modern Machineries Limited amounting to Rs. 6,19,500.

The old machinery and plant account stood in the books of the Company at Rs. 3,78,000. There was also a Depreciation Fund in the books, the accumulated credit balance of which amounted to Rs. 73,500. Some of the materials composing the old machinery were found to be in good condition, and the Modern Machineries Limited agreed to take over shafting, etc. valued at Rs. 38,500 for use again: whilst the remainder was put up for auction and realised Rs. 84,000 (net).

Make the entries necessary to record these transactions in the books of the Textiles Limited and state how you would deal with the balance of the "Old Machinery and Plant Account."

*Answer —*

The Textile Company.  
JOURNAL ENTRIES

	L.F.	Rs.	Rs.
New Machinery Account      Dr To Messrs Modern Machineries, Ltd (Being the amount payable to Modern Machineries Limited, for constructing new Machi- nery, after deducting the value of old materials sold to them)		5,81,000	5,81,000
New Machinery Account      Dr. To Old Machinery Account (Being value of old parts of Machinery taken in use for new Machinery)		38,500	38,500
Bank                              Dr. To Old Machinery Account (Being Cash realised by sale of Old Machinery)		84,000	84,000
Depreciation Fund Account      Dr To Old Machinery Account (Being accumulated depreciation fund transferred to the latter Account).		73,500	73,500

The balance of Rs 1,82,000 on the old Machinery Account represents loss, and it is desirable to write it off in the current year if profit permits. It being an extraordinary loss, it would not be unsound if the same is spread over two or three years, so as not to burden any particular year with the extraordinary heavy amount.

*Note* — It is presumed that the Depreciation Fund Account standing in the books was created solely for the purpose of Machinery and Plant and not for any other asset. If it is not so, then only a proportionate amount of the

Depreciation Fund Account representing the total amount of Depreciation reserved for in respect of Plant and Machinery will be credited to Old Machinery Account.

*Question 7.*—The Perfect Preserves Limited sends out its Refrigerators to dealers on "Sale or Return." All such transactions are, however, treated like actual sales and are passed through the Sales Book. Just before the end of the financial year, 2 Refrigerators which had cost Rs. 5,000 each, have been sent on "Sale or Return" and have been debited to customers at Rs. 7,500 each. How would you adjust these transactions for the purpose of the Company's Profit and Loss Account and Balance Sheet.

*Answer .—*

The following entry would be necessary to adjust the accounts :—

	L.F	Rs.	Rs.
Sales Account <span style="float: right;">Dr.</span>		15,000	
To Debtors on Sale or Return Account			15,000
(Being the entry to reverse the Sale of two Cars on "Sale or Return" as the same are not sold).			

Debtors on "Sale or Return" of Rs. 15,000 would be shown in the Balance Sheet by way of deduction from the total debtors and the two Cars on hand on "Sale or Return" lying with the dealers will be valued at cost, *viz.*, Rs. 11,000 and included in the Closing Stock.

## HIGHER ACCOUNTANCY—PART II

1946

*Question 1* —The firm of K & L decide to turn their business into a Limited Liability Company as from 1st January, 1944. The firm's Balance Sheet at that date was as follows —

### K & L—BALANCE SHEET—1st January, 1944

Liabilities	Rs.	Assets.	Rs.
Capital Accounts	Rs.	Freehold Property	20,000
K	25,500	Fixtures and Fittings	10,000
L	8,500	Stock-in-trade	20,000
	34,000	Sundry Debtors	15,000
Trade Creditors	30,000	Cash at Bank	7,900
Loan on Mortgage	9,000	Cash at Hand	100
	73,000		73,000

Profits are shared—K, two-thirds, L, one-third.

The Sale Agreement provides that the Company shall take over all assets and liabilities with the exception of Sundry Debtors and Loan on Mortgage. The purchase consideration is Rs. 25,000 payable in Ordinary Shares of Re 1 each (fully paid). It is agreed that the Loan on Mortgage shall be paid off, and the Book Debts collected by the Company on behalf of the firm, the amount due to the late partners being paid to them as required, the balance standing at the credit of their respective accounts to bear interest at the rate of 6 per cent per annum.

Close the firm's books at 1st January, 1944.

*Answer.—***REALIZATION ACCOUNT**

	Rs.		Rs.
To Sundry Assets—		By Sundry Liabilities—	
Freeholds Property	20,000	Trade Creditors	30,000
Fixture & Fittings	10,000	" Shares Account	25,000
Stock in Trade	10,000	" Realisation Suspense	
Cash-at-Bank	7,900	A/c (transfor of Loan	
Cash-in-hand	100	on Mortgage,	9,000
To Realization Suspense		" K—	
A/c.—		Share of Loss	6,000
" Transfer of Sundry		L—	
Debtors	15,000	Share of Loss	3,000
	Rs. 73,000		Rs. 73,000

**K's Capital Account.**

	Rs.		Rs.
To Realisation Account	6,000	By Balance	25,000
" Shares 2/3rd shares			
of loss in Purchasing			
Co's Account	19,500		
	Rs. 25,500		Rs. 25,000

**L's Capital Account.**

	Rs.		Rs.
To Realisation Account	3,000	By Balance	8,500
" Share 1/3rd share			
of loss in Purchasing			
Co's Account	5,500		
	Rs. 8,500		8,500

**SHARES in the Purchasing Co's ACCOUNT.**

	Rs.		Rs.
To K's Capital Account	19,500	By Purchasing Co.	25,000
" L's Capital Account	5,500		
	Rs. 25,000		Rs. 25,000

*Note*—Similarly all Ledger Accounts in the books of K. & L. should be closed.

## Question 2 —

The following is the Balance Sheet of Lyons Ltd., at 31st December, 1945:—

LIABILITIES	Rs	ASSETS	Rs
Share Capital (Authorised and Issued) —		Goodwill	25,000
100,000 Re. 1 Cum. Preference shares at 6% fully paid	1,00,000	Freehold Property at cost, less depreciation written off	90,000
200,000 Re. 1 Ordinary Shares	2,00,000	Stocks	85,000
Creditors	75,000	Debtors	35,000
Bank (Overdraft)	15,000	Cash at Bank	40,000
General Reserve	70,000	Investments (Market value Rs 86,000)	500
		Profit & Loss Account	80,500
			1,04,000
			4,60,000

Draft a Capital Reduction Scheme, which in your judgment would be equitable for submission to the Directors. The Cumulative Preference Dividends are in arrears for two years.

*Answer.*—Draft of Capital Reconstruction Scheme.—

(1) It would seem wrong in principle to allow the Reserve Fund to stand as there cannot be a reserve fund along with a heavy debit balance on Profit & Loss Account appearing in the Balance Sheet. This Fund should be utilised in writing off, Rs 25,000 for Goodwill and Rs. 45,000 for a part of the accumulated loss. The Balance in the Profit & Loss Account would come down to Rs. 59,000.

(2) The Preferential Shares are usually preferential as also to return of capital and they will not stand to lose anything in respect of capital refund in case the company went into liquidation. Evidently, therefore, the Preference Shareholders would not be prepared to make any sacrifice as the Company possesses ample assets to satisfy them. If the Share Capital of the Company is reduced the whole burden must fall on the ordinary shareholders. The Company requires about Rs 50,000 for writing off the debit balance in the Profit & Loss Account. The ordinary shareholder should not object to the nominal value of their shares being reduced to annas twelve per share. If the shareholders agree to this proposal the Company will get Rs 50,000 to reduce the loss in Profit & Loss Account to Rs 1,000 only.

(3) In view of the entire Capital loss being borne by the ordinary shareholders it would seem fair to call upon the Preference Shareholders to at least waive their right towards arrears of dividend. If they agree to this, the Company can convert their existing rate of dividend of 6 per cent. to 7 per cent. by way of compensation for the loss they agree to bear.

(4) It would look advisable to realise the Investments and out of the premium realised write off further the debit balance on the Profit & Loss Account and out of the sale proceeds pay off the Bank Overdraft and use the balance for day to day working of the Company.

*Question 3*—A firm of Coal Merchants purchased Railway Trucks on the Hire Purchase System, payments, therefore, being agreed at Rs 6,000 per annum for five years, the payments to be made at the end of each year. The cash value of the trucks was Rs 26,000, the vendor's charge for interest being at the rate of Rs 5 per cent. per annum on the yearly balances.

Show the entries in the Coal Merchants' books recording these transactions and provide for depreciation on the trucks at the rate of 10 per cent. per annum.

Answer —

Note — It may be presumed that the transaction was done on 1st January 1939.

## TRUCKS ACCOUNT

1939 Dec. 31	To Vendors' Account	Rs 4,700	1939 Dec. 31	By Depreciation " Balance c/d	Rs 2,600 2,100 4,700
1940 Jan. 1 Dec. 31	To Balance b/d. " Vendors' Account	4,700 2,100 5,000 7,100	1940 Dec. 31	By Depreciation " Balance c/d.	2,340 4,760 7,100
1941 Jan. 1 Dec. 31	To Balance b/d. " Vendors' Account	4,760 5,160 9,920	1941 Dec. 31	By Depreciation " Balance b/d.	2,106 7,814 9,920
1942 Jan. 1 Dec. 31	To Balance b/d " Vendors' Account	7,814 5,520 13,334	1942 Dec. 31	By Depreciation " Balance b/d	1,895 11,439 13,334
1943 Jan. 1 Dec. 31	To Balance b/d " Vendors' Account	11,439 5,880 17,319	1943 Dec. 31	By Depreciation " Balance b/d.	1,705 15,614 17,319



## VENDERS' ACCOUNT

1939 Dec. 31	To Bank	Rs. 6,000 <u>6,000</u>	1939 Dec. 31	By Trucks' Account " Interest Account	Rs. 4,700 1,300 <u>6,000</u>
1940 Dec. 31	To Bank	6,000 <u>6,000</u>	1940 Dec. 31	By Trucks' Account " Interest Account	5,000 1,000 <u>6,000</u>
1941 Dec. 31	To Bank	6,000 <u>6,000</u>	1941 Dec. 31	By Trucks' Account " Interest Account	5,160 840 <u>6,000</u>
1942 Dec. 31	To Bank	6,000 <u>6,000</u>	1942 Dec. 31	By Trucks' Account " Interest Account	5,520 480 <u>6,000</u>
1943 Dec. 31	To Bank	6,000 <u>6,000</u>	1943 Dec. 31	By Trucks' Account " Interest Account	5,880 120 <u>6,000</u>

## INTEREST ACCOUNT.

1939 Dec. 31	To Venders' Account	Rs. 1,300	1939 Dec. 31	By P. & L. Account	Rs. 1,300
1940 Dec. 31	To Venders' Account	1,000	1940 Dec. 31	By P. & L. Account	1,000
1941 Dec. 31	To Venders' Account	840	1941 Dec. 31	By P. & L. Account	840
1942 Dec. 31	To Venders' Account	480	1942 Dec. 31	By P. & L. Account	480
1943 Dec. 31	To Venders' Account	120	1943 Dec. 31	By P. & L. Account	120

*Question 4 :—*

From the following figures prepare a combined Balance Sheet of the London Clearing Banks as on 30th June, 1944.

	£.
Investments in Affiliations	24,593,439
Note Issue	3,002,023
Acceptances and Engagements	86,580,356
Money at Call or Short Notice	144,856,946
Investments	252, 140, 278
Current, Deposit and other Accounts	1,748,070,846
Balances with, and Cheques in course of Collection in, other Banks in Great Britain and Ireland	66,475,250
Capital (Paid up)	70,717,730
Coin, Bank and Currency Notes, and Balances with Bank of England	220,700,740
Advances	948,845,700
Liabilities of Customers for Acceptances, Engagements etc.	86,580,356
Bank Premises	32,741,525
Reserve Fund	57,750,371
Bills Discounted	189,187,092

Answer — BALANCE SHEET

LIABILITIES	£	ASSETS	£
Authorised Capital— .....Share of £..... each		Coins, Bank and ..	220,700,740
Subscribed Capital— ..... Shares at ..... each		Balance with	66,475,250
Paid up Capital— .....Shares at ... .. each		Money at Call and Short Notice	144,856,946
Reserve Fund	70,717,730	Investments	252,140,278
Notes Issued	37,750,371	Investments in Affiliations	24,593,439
Current Deposits & other a/cs	3,002,023	Advances	1,138,032,792
Liabilities of Customers for accep- tances etc as per contra	1,748,070,846	Bills Discounted	86,580,356
		Acceptances & Engagements as per contra	
	1,966,121,326		1,966,121,326

## Question 5:—

From the following figures draft the Balance Sheet of A, B & Co., Ltd., Manufacturers, in conformity with the requirements of the Indian Companies Act.—

	Nominal Capital (200,000 shares of Re. 1 each).	Rs.	a.	P.
	...	2,00,000	0	0
Capital Subscribed (79,500 shares of Re. 1 each)	...	79,500	0	0
Debentures 5 per cent.	...	50,000	0	0
Freehold Premises (at cost)	...	17,504	0	0
Reserve for Debenture Interest	...	1,096	13	6
Bills Payable	...	16,000	0	0
Plant and Machinery (at Cost, less Depreciation)	...	40,000	0	0
Plant and Machinery Additions during year	...	3,600	0	0
Plant and Machinery Depreciation	...	4,000	0	0
Sundry Creditors	...	18,950	0	0
Office Fittings (at Cost, less Depreciation)	...	500	0	0
Office Fittings Depreciation	...	62	0	0
Unpaid Dividends	...	25	0	0
Reserve Fund	...	8,000	0	0
Investment of Reserve Fund	...	8,000	0	0
Profit and Loss Account	...	10,782	0	0
Preliminary Expenses (balance)	...	450	0	0
Debenture Issue Expenses (balance)	...	400	0	0
Stock-in-Trade	...	60,000	0	0
Bills Receivable	...	15,000	0	0
Sundry Debtors (including loan to A B a Director, of Rs. 2,000)	...	40,000	0	0
Cash	...	2,962	7	6

Answer — BALANCE SHEET OF A, B & Co, Ltd

	Rs.	a	p.		Rs	Rs	a	p.
Authorised Capital— 200,000 shares of Re. 1 each	2,00,000	0	0	Freehold Premises		17,504	0	0
Subscribed & Called-up— 79,500 shares of Re. 1 each	79,500	0	0	Plant & Machinery as per last Balance Sheet	40,000			
Reserve Fund	8,000	0	0	Additions during the year	3,600			
Debentures (5%)	50,000	0	0	Less Depreciation	43,600	39,600	0	0
Reserve for Debenture Interest	1,096	13	6	Office Fittings as per last Balance Sheet	4,000			
Sundry Creditors	16,000			Less Depreciation	500	437	6	0
Bills Payable	16,950	0	0	Preliminary Expenses		450	0	0
On open A/c.				Debentures Issue Expenses		400	0	0
Unpaid Dividends	25	0	0	Stock-in-Trade		60,000	0	0
Profit and Loss A/c.	10,782	0	0	Sundry Debtors		40,000	0	0
				(Among the above debts a Direc- tor owes Rs 2,000)				
				Bills Receivable		15,000	0	0
				Investment (Reserve Fund)		8,000	0	0
				Cash at hand		2,962	7	6
Total Rs.	1,84,353	13	6	Total Rs		1,84,353	13	6

**Question 6.**—A Company with a Capital of Rs. 1,00,000 (divided into shares of Re 1 each) and Reserves and Undistributed Profits of Rs. 20,000 sells its business for Rs. 1,50,000, payable in Shares of the New Company of Rs. 5 each. On what basis will the new Shares be issued.

**Answer .**—There are one lac shares of Re. 1/- each in the first company while the New Company shall have 30,000 shares of Rs 5/- each. So a holder of 10 shares of the Old Company will receive 3 shares of the New Company.

**Question 7.**—M & N, partners, took out partnership policy for Rs. 18,000 without profits at an annual premium of Rs. 7,000 such premium being a charge against the firm's profits, which were shared as to M two-thirds and as to N one-third. M died on 31st March, 1944. Three years premiums had then been paid, M's share of profits from 1st January to 31st March, 1944, were Rs. 1,233. The Partnership Deed provided for—

(a) Interest at 5 per cent. on balance of capital at credit at date of last Balance Sheet (Rs. 24,000),

(b) Goodwill (in case of death on basis of two years' purchase of average profits of the last three years, after charging interest on capital but excluding the insurance premiums.

The net profits for the three years, after charging interest on capital and insurance premiums, were Rs. 6,000, Rs. 7,600 and Rs. 7,400. M's drawings for the three months to 31st March amounted to Rs. 1,800.

Prepare M's Capital Account as at the date of his death for settlement with his Executors.

Answer:—

## M's CAPITAL ACCOUNT.

1943 Mar. 31	Rs. 1,800-0-0 45,999-10-8	1943 Mar. 31	Rs.
To Drawings		By Balance b/fd.	24,000-0-0
„ Executors of M—		„ Profit from 1st Jan., to date	1,233-0-0
		„ Interest on Capital for 3 months	300-0-0
		„ Share of Goodwill	10,266-10-8
		„ Life Policy A/c -2/3 share of Proceeds	12,000-0-0
	47,799-10-8		47,799-10-8



*Note*—(1) It is assumed that M's share of profits as given for the 3 months to 31st March, 1943, is arrived at after charging interest on his Capital for the period.

(2) The amount payable for Goodwill is arrived at thus.—

			Rs.
Net Profits	Rs. 6,000 +	Insurance Premium	Rs. 700 = 6,700
" "	Rs. 7,600 +	" "	Rs. 700 = 8,300
" "	Rs 7 400 +	" "	Rs. 700 = 8,100
			<hr/>
			3 ) 23,100
			<hr/>
∴ Average Profits			= 7,700
			x 2
			<hr/>
∴ Two years' purchase			= 15,400
∴ Rs. 10,266-10-8	represents two-thirds share thereof.		

## HIGHER ACCOUNTANCY—PART II

1947

*Question 1*—A and B having Capitals of Rs. 20,000, and Rs. 15,000 respectively admit C into partnership on terms that he shall contribute Rs. 10,000 as Capital and pay them Rs. 14,000 for his share of goodwill. Interest on Capital to be 5% per annum (charged to Profit & Loss account) and Profits to be shared in the proportion of 4, 3, 2. C has only Rs. 10,000 which he pays in as Capital. The profits of the partnership are Rs. 25,000 before charging interest on Capital. Pass Journal and prepare capital account of respective partners.

*Answer :—*

### JOURNAL ENTRIES

	Rs.	Rs.
Goodwill Account—	14,000	
To A = 5/9th of 14,000		8 000
,, B = 4/9th of 14,000		6,000
(Share of Goodwill created on admission of new partner in proportion to their respective Capitals).		
Profit & Loss Account—	2,950	
To Capital Account A		1,400
"     "     "     B		1,050
"     "     "     C		500
(Interest on Capitals @ 5% P A)		
Profit & Loss Account—	22,050	
To A 4/9 of 22050		9,800
,, B 3/9 of 22050		7,350
,, C 2/9 of 22050		4,900

## A's Capital Account.

	Rs.		Rs.
To Balance c/d	39,200	By Balance	20,000
		„ Share of Goodwill	8,000
		„ Interest	1,400
		„ Share of Profit	9,800
	<u>Rs. 39,200</u>		<u>Rs. 39,200</u>
		By Balance b/d.	Rs. 39,200

## B's Capital Account.

	Rs.		Rs.
To Balance c/d	29,400	By Balance	15,000
		„ Share of Goodwill	6,000
		„ Interest	1,050
		„ Share of Profit	7,350
	<u>Rs. 29,400</u>		<u>Rs. 29,400</u>
		By Balance b/d.	Rs. 29,400

## C's Capital Account.

	Rs.		Rs.
To Balance c/d	15,400	By Balance	10,000
		„ Interest	500
		„ Share of Profit	4,900
	<u>Rs. 15,400</u>		<u>Rs. 15,400</u>
		By Balance b/d.	Rs. 15,400

**Question 2.**—The following particulars have been extracted from the Balance Sheet of *solid d' or Ltd*, as on 31st December, 1945.

Capital —	£.	£.
Nominal, 10,000 5% Preference Shares of £ 5 each	50,000	
100,000 Ordinary shares of £. 1 each	100,000	
	<hr/> 150,000	
Issued 5,000 5% Preference Shares of £ 5 each	25,000	
50,000 Ordinary shares of £ 1 each	50,000	
	<hr/>	75,000
Reserve Fund		20,000
Profit and Loss Account (Balance)		12,000

During the year 1946 Resolutions were passed as follows —

(1) A Resolution converting the Preference Shares of £ 1 each

(2) A Resolution declaring a bonus of 20% on the Ordinary Shares to be provided as to £ 6,000 out of the Reserve Fund and as to remainder out of the Balance of Profit and Loss Account

The Bonus to be satisfied by the issue of one fully paid Ordinary Share for every five Ordinary Shares held

Give Journal entries which are necessary to carry out the above Resolutions, and show how they would affect the Balance Sheet of the Company as on 31st December, 1946. Assume that the Profit for the year 1946 amounted to £ 4,000.

*Answer.*—

#### JOURNAL ENTRIES

	Dr.	£	£
Reserve Fund Account		6,000	
Profit & Loss Appropriation Account		4,000	
To Bonus to Ordinary Shareholders' Account			10,000
(Being the amount of bonus declared partly out of Reserve Fund and partly out of Profit & Loss Appropriation A/c balance)			
Bonus to Ordinary Shareholders' Account Dr		10,000	
To Ordinary Share Capital Account			10,000
(Being the issue of 10,000 Ordinary Shares of £ 1 each as fully paid in satisfaction of the Bonus declared)			

The conversion of £ 5 Preference Shares into five shares of £ 1 each does not require any Journal entry. A note, however, will have to be made in the Share Capital Account that the £ 5 shares have been converted into 5 shares of £ 1 each, as per Resolution dated ..... The Share Certificates will have to be called back and stamped with a similar note. A mention must also be made to the same effect in the Register of Members, and the Memorandum and Articles of Association of the Company will have to be altered accordingly.

The Balance Sheet of the Company on 31st December, 1946, will show the items as follows:—

	£.	£.
Nominal Capital.—		
50,000 5% Preference Shares of £ 1 each	50,000	
100,000 Ordinary Shares of £ 1 each	100,000	
	150,000	
Issued Capital.—		
25,000 5% Preference Shares of £ 1 each, fully called	25,000	
60,000 Ordinary Shares of £ 1 each, fully called	60,000	85,000
Reserve Fund —		
Balance	20,000	
Less Transfer to Bonus Account	6,000	14,000
Profit & Loss Appropriation Account.—		
Balance from last year	12,000	
Less Transfer to Bonus Account	4,000	
	8,000	
Add Net Profit this year	4,000	12,000

## Question 3—

The following figures are extracted from the General Ledger of a life Assurance Co., Ltd., for the year 1946 —

	Rs		Rs
Cash in hand	1,900	British Government Loans	5,69,517
Cash at Bank	9,020	Annuities due but not paid	427
Life Fund on 1st Jan, 1946	55,56,148	Premiums received in advance	575
Share Capital	1,00,000	Development Loan	4,15,000
Interest a/c but not receivable	69,613	Stamps on hand	269
Investment Reserve Fund	88,000	Mortgages out of British India	3,94,360
Outstanding Premiums	77,651	Claims by Death	3,37,955
Premiums (less re-insurances)	3,55,674	Claims by Survivance	32,226
Loans on Securities of Policees	4,25,360	Mortgages in British India	8,02,956
Consideration for annuities to be granted	11,338	Surrendere	37,303
Railway shares	20,42,477	Income Tax on Profits	8,594
Interest and Dividend	2,23,535	Annuities	38,688
Municipal Bonds	8,50,320	Bonus in reduction of Premium	11,156
Fines for revival of Policies	358	Commission	11,417
Foreign Government Bonds	1,72,760	Dividend to shareholders	9,878
Claims due but not paid	76,135	Expenses of management	40,070
Bank Loan	50,000	Interest outstanding on Investments	3,700

You are required to make out the Revenue Account of the Company for the year ended 1946 and the Balance Sheet as on 31st December, 1946, from the above figures after making adjustments for the following —

- (a) Further Bonus utilised in reduction of Life Insurance Premium Rs. 6,500.  
 (b) Claims covered under re-insurance Rs. 27,000.

Answer:—

**REVENUE ACCOUNT**  
For the year ended 31st December 1946.

Dividends to Shareholders					
Claims under Policies (Including Provision for claims due or intimated) less re-assurance —					
By Death	3,37,955				
By Maturity	32,226				
	<hr/>				
Less covered under	3,70,181				
Re assurance	27,000				
	<hr/>				
Annuities					
Surrenders including surrender of bonus					
Bonus in reduction of premiums					
Commission					
Management Expenses					
Income-Tax					
Balance of Life Fund at the end of the year as shown in the Balance Sheet					
		</			

**BALANCE SHEET**  
As at 31st December, 1946.

LIABILITIES	Rs.	ASSETS	Rs.
Share Capital paid up	1,00,000	Loans on Mortgages within British India	9,02,956
Life Fund	56,46,786	Loans on Mortgages outside British India	3,94,360
Investment Reserve Fund	88,000	Loan on Policies within their Surrender Value	4,25,360
Estimated liability in respect of outstanding claims, whether due or intimated	76,135	Investments —	
Annuities due and unpaid	427	British Govt Securities	5,69,517
Bank Loan	50,000	Foreign Govt Securities	1,72,760
		Municipal Securities	8,50,320
		Development Loan	4,15,000
		Railway Shares and Debentures	20,42,477
Premiums received in advance	575	Outstanding Premiums	77,651
		Amount due from other Insurance Companies (re-insurance claims)	27,000
		Interest & Dividends outstanding	3,700
		Interest accruing but not due	69,613
		Stamps in hand	₹ 269
		Cash in hand	1,900
		Cash at Bank	9,020
	Rs. 59,61,903		Rs. 59,61,903

Note — (1) In the absence of detailed information Premium Income has not been splitted up.  
 (2) As the details of Expenses of Management are not given, it is shown in the Revenue Account under one heading.



Question 4.— The Rajputana Syndicate Ltd., at 31st December, 1945, stood as follows:—

	Rs.		Rs.
1,000, Rs. 10 6% cumulative Preference Shares	10,000	Expenditure on Patents	Rs. 8,500
1,500 Rs. 1, Ordinary Shares	1,500	Cash in hand	25
4% Debentures	3,000	Loss on Trading	6,220
Creditors	1,300	Stock of materials	325
Bank	450	Sundry Debtors	180
		W. Barwick Loan @ 5% p. a.	1,000
	16,250		16,250

The Preference Dividend is at above date 5 years in arrears. There are no transactions until June 30, 1946; on this date the Company is supposed to be wound up. The amounts then realised are Patents Rs. 20,000, Stock Rs. 180, Sundry Debtors Rs. 120. The expenses of winding up are Rs. 800. The Preference Shares are only entitled to repayment in full with arrears. Prepare a statement showing the distribution of assets Ignore Income-tax.

W. Barwick holds Rs. 500 Debentures, 100 Preference Shares, and 500 Ordinary Shares. Prepare a statement showing how much is due to him.

Answer --

Rajputana Syndicate, Ltd.,  
Realisation Account

	Rs.	Rs.
To Cash in hand	25	
" Patents	20,000	800
" Stock	180	1,300
" Sundry Debtors	120	450
" Interest on Loan to Barwick	25	3,000
" Loan to W Barwick	1,000	60
	21,350	3,000
		10,000
		2,740
		21,350

W Barwick Account

	Rs.	a	p	Rs.	a	p.
To Loan	1,000			By Debentures	500	
Interest on Loan for	5			" Interest	10	
6 months @ 5%	28			" Arrears of Dividend on		
Cash	1,698	5	4	Preference Shares	300	
				" Refund on Preference Shares	1,000	
				Refund on Ordinary Shares	913	5 4
	2,723	5	4		2,723	5 4
				Rs.		

**Question 5:—**

A partner has withdrawn, on account of profits for half-year ended 30th June, 1944, the undermentioned amounts.—

January 18      —Rs. 1,300.

February 29     —Rs. 1,800.

March 22        —Rs. 300.

Find the average due date and calculate interest at 5%.

*Answer.—*

Amount	Days.	Products.
1,300	164	213200
1,800	122	219600
300	39	11700
<u>3,400</u>		<u>444500</u>

444500/3400 gives 131 days, prior to 30th June as the average due date

Interest on Rs. 3,400 at 5% for 131 days = Rs. 61 approximately.

**Question 6.**—You are preparing the Balance Sheet of a Limited Company of which you are the chief accountant, and find that there are bills under discount amounting to Rs. 10,750. On going through the books you find that Rs. 1,000 worth of bills will be probably dishonoured on maturity, but there is a reasonable chance of eventually receiving eight annas in a rupee on the Rs. 1,000. How would you deal with these bills under discount and how should they appear in the Co's published accounts.

*Answer.*—Since there is a probability that Rs. 1,000 worth of Bills will be dishonoured, it is necessary to provide for this contingency in order that the year under review may not benefit at the expense of the next year when this likely loss might arise. As there is likelihood of half the amount being recoverable, the other half, viz Rs. 500 can be provided for by debiting Profit & Loss Account and crediting Reserve for Doubtful Bills Account. A note will also be made at the foot of the Balance Sheet to the effect that there is a Contingent Liability on Bills under Discount for Rs. 10,750.

Question 7.—Write short notes on —

- (1) Rebate on Bills Discounted.
- (2) Money at Call and short notice.
- (3) Liability of customers for acceptances and endorsements.

Answer:—

(1) *Rebate on Bills Discounted.*—When a bank discounts a bill, the discount charged to the customer is immediately credited to Discount Account in the bank's books, in daily totals through the Bills Received for Discount Register. But the bank is not entitled to take credit for any greater amount of discount than has accrued to the date of closing the books. The discount is therefore apportioned, and the amount appertaining to the succeeding period is carried forward under the above heading.

(2) *Money Call and Short Notice.*—This item represents money lent to bill brokers, stock brokers and others at rates varying with the monetary resources of the market and the demand for loanable capital. It runs from day to day or is repayable at short notice. Next to the bank's own cash and its balance with the Reserve Bank this is the most liquid asset of the bank for the money lent is repayable at call or within seven days and is easily called in.

(3) *Liability of customers for acceptances and endorsements.*—These items denote bills which the bank has accepted or indorsed on behalf of its customers. This is usually done in the case of foreign bills as it greatly facilitates their negotiation abroad. The customer is of course liable to parties abroad. These items therefore appear on both sides of the balance sheet.

*Question 1.*—The Rayon Co. Ltd., began business on January 1, with a capital of Rs. 4,00,000 in 80,000 shares of Rs. 5 each, Re. 1 to be paid on allotment, Re. 1 on March 1 and Re. 1 on June 1. Freehold land, valued Rs. 25,000, was bought and buildings erected at a cost of Rs. 1,12,500. There was also purchased plant Rs. 37,500; office furniture Rs. 1,750 and preliminary expenses amounted to Rs. 3,750. The works were finished on June 30 and all liabilities thereon were paid at that date. The following were outstanding as arrears, viz.—On allotment Rs. 1,750; on first call Rs. 2,800; and on second call Rs. 3,450. Cash in bank amounted to Rs. 51,500. Make the necessary entries for the above and prepare the Balance Sheet at June 30

On December 31, Stock amounted to Rs. 78,000. From the following Trial Balance prepare Trading and Profit and Loss Accounts and Balance Sheet after depreciating Freehold Buildings  $1\frac{1}{2}\%$  per annum, Plant 10% per annum, Furniture  $7\frac{1}{2}\%$  per annum and Preliminary Expenses one-sixth.

	Rs.	Rs.
Freehold land	25,000	
Freehold buildings	1,12,500	
Plant	37,500	
Office Furniture	1,750	
Wages	40,000	
Preliminary expenses	3,750	
Calls in arrears, viz.,		
Allotment	1,300	
First Call	1,000	
Second Call	1,200	
Purchases	1,23,750	
Salaries	22,000	
Directors' and Auditors' Fees	4,750	
Stationery	1,200	
Office Expenses	1,800	
Rates, etc.	600	
Sundry debtors	29,400	
Bank	31,250	
Capital		2,40,000
Sales		1,75,000
Creditors		23,750
	4,38,750	4,38,750

Answer.—

**BALANCE-SHEET OF RAYON Co. Ltd ;**  
As on 30th June.

Capital—	Rs	Land & Buildings—	Rs.	Rs.
Authorised— 80,000 shares of Rs. 5 each	4,00,000	Freehold Land	25,000	1,37,500
		"    Building	<u>1,12,500</u>	
Issued & Subscribed— 80,000 shares at Rs 3 each	2,40,000	Plant & Machinery		37,500
		Office Furniture		1,750
		Cash on hand		51,500
		Preliminary Expenses		<u>3,750</u>
Paid-up—80,000 Shares @ Rs. 3—each	2,40,000			
Less Calls in arrear	<u>8,000</u>			
	Rs. 2,32,000		Rs.	<u>2,32,000</u>

**RAYON AND COMPANY LIMITED.**  
**TRADING AND PROFIT LOSS A/c.**  
 As on 31st December.

	Rs.		Rs.
To Purchases	1,23,750	By Sales	1,75,000
" Wages	40,000	" Stock	78,000
" Gross Profit	89,250		<u>2,53,000</u>
	<u>2,53,000</u>		
To Office Expenses	1,800	By Gross Profit	89,50
" Rates	600		
" Stationery	1,200		
" Salaries	22,000		
" Directors & Auditor's fee	4,750		
" Preliminary Expenses	625		
" Depreciation Freehold Buildings	1,687		
1½% on Rs. 1,12,500	8		
" Plant & Machinery 10% on	3,750		
Rs. 37,500	131		
" Furniture 7½% on Rs. 1,750	52,706		
" Net Profit	89,250		
			<u>Rs. 89,250</u>

FRAYON & Co Ltd.,  
Balance-Sheet as on 31st December.

	Rs	a	p		Rs.	a	p.
Authorised Capital—80,000 shares of Rs. 5 each	4,00,000			Freehold Land	1,12,500	25,000	
				Buildings	1687½		
				Less Depreciation		1,10,812	8 0
Issued & Subscribed Capital 80,000 shares of Rs. 3 each	2,40,000			Plant & Machinery	37,500	33,750	0 0
				Less Depreciation	3,750		
Paid-up Capital—60,000 shares of Rs 3 each	2,40,000			Office Furniture	1,750	1,618	120
Less Calls in arrear	3,500			Less Depreciation	13½		
	2,36,500						
Sundry Creditors	23,750			Sundry Debt		29,400	
				Stock		78,000	
Net Profit	52,706	4	0	Cash at Bank		31,250	
				Preliminary Expn	3,750	3,125	
				Less written off	625		
	3,12,956	4	0			3,12,956	4 0



*Question 2.*—A, B and C were the owners of a patent medicine, sharing profits equally. A died on 31st December, 1940 leaving two children; he made B and C his Executors and Trustees. His will and the partnership deed provided that the business should be continued and the children maintained and educated till the year 1945 when they both come of age. They were then to receive their father's share and capital in the business less any sums paid out during their minority. You are instructed to draw up Balance-sheet at the end of 1944 showing the position, also a Profit & Loss Account for that year. The material figures for the latter are as follows :—

	Rs.
Sales and commission earned	1,02,000
Warehouse wages	5,100
Salaries	14,200
Commission paid	3,400
Travelling expenses	1,890
Rent of Warehouse	780
Advertising	18,700
Purchase of materials	26,390
Stock at commencement of year	8,900
Stock at end of year	8,200
Miscellaneous Expenses	1,020

The capital accounts of the partners are Rs. 10,000 each, and the liabilities on 31st December 1944 were Rs. 12,300 on bills and Rs. 33,800 to sundry creditors. The firm had a lease of the offices valued at Rs. 1,050, book debts Rs. 56,500, bills receivable Rs. 14,800 and cash at bank Rs. 7,100.

B and C had invested the whole of A's share of the profits since his death, and this Investment account stood at Rs. 45,300 at the above date. They had paid the maintenance and other charges amounting to Rs. 11,270 which had been debited to an account called Accumulation of Income Account.

B and C were both entitled to draw a special remuneration of Rs. 3,500 each year against the profit.

Draw up an account showing what the children will receive assuming that all adjustments have been made in the books upto 1st January, 1944.

Answer—

## Trading and Profit &amp; Loss Account for the year ended 31st December, 1944

	Rs.	a.	p.		Rs.	a.	p.
To Stock on 1-1-44	8,900	0	0	By Sales & Commission	1,02,000	0	0
" Purchases	26,390	0	0	Stock on 31-12-44	8,200	0	0
" Wages	5,100	0	0				
" Gross Profit c/d.	69,810	0	0		1,10,200	0	0
Rs.	1,10,200	0	0				
To Salaries	14,200	0	0				
" Commission	3,400	0	0				
" Travelling Commission	1,890	0	0				
" Miscellaneous Expenses	1,020	0	0	By Gross Profit b/d.	69,810	0	0
" Rent	780	0	0				
" Advertising	18,700	0	0				
" Partners' salaries	7,000	0	0				
" Net profit c/d	22,820	0	0		69,810	0	0
Rs.	69,810	0	0				
To A's A/c. (deceased)	7,606	13	4				
" B's Account Current	7,606	13	4	By Net Profit b/d.	22,820	0	0
" C's Current Account	7,606	13	4				
Rs.	22,820	0	0		22,820	0	0



**Question 3.**—Make the necessary entries in Journal Form to record the following transactions in the Books of accounts of a Limited Company:—

(1) January 1 The Company purchased from vendors plant and machinery valued at £5,000, stock-in-trade valued at £2,500 and Patent Rights valued at £3,000.

(2) January 10. The Company allotted to vendors, in part payment of purchase of these assets, 800 fully paid ordinary shares of £10 each, and issued 25 mortgage debentures of £100 each in satisfaction of the balance of purchase money.

(3) January 15 The Company allotted to applicants 1,000 ordinary shares of £10 each having received on same date £2 per share the amount payable on application and allotment.

(4) February 16 First Call of £2 per share made on 1,000 ordinary shares.

(5) February 20 Payment of first call received in full.

(6) March 1 The Company received £2,500 in respect of Book Debts due to vendors agreed to be collected on their behalf Vendors agreed to accept 30 mortgage debentures of £100 each in payment thereof, and these debentures were issued to them on this date

(7) April 1. Certain shareholders, being desirous of paying up the balance due on their shares pending further calls the company agreed to allow them 5% per annum Interest on calls paid in advance £3,000 were received on this date from shareholders under this arrangement

(8) April 15 The Company applied the sum of £2,300 in redeeming 20 debentures of £100 each at a premium of 10 per cent with £100 interest thereon to date of redemption

Answer :—

## JOURNAL

July 1.	Plant and Machinery Stock in Trade Patents Rights To Vendors (For value of purchases made).	5,000 2,500 3,000	10,500
Jan. 10.	Vendors To Share Capital A/c. „ Mortgage Debenture (For 800 fully paid shares of £10 each 25 mortgage Debentures of £100 each issued as fully paid).	10,500	8,000 2,500
Jan. 15.	Cash (or Bank) To application & Allotment A/c. (For cash received against 1,000 ordinary shares at £2 per share).	2,000	2,000
Feb. 15	First Call A/c. To Share Capital (For First Call at £2 per share on 100 Ordinary Shares).	2,000	2,000
Feb. 20.	Cash (or Bank) To First Call A/c. (For Call money on 1,000 shares at £2 each).	2,000	2,000
March 1.	Cash (or Bank) To Vendors (Book debts Collected)	2,500	2,500

March 1.	Vendors To Mortgage Debentures A/c. (For 25 debentures of £100 each issued).	2,500	2,500
April 1.	Cash (or Bank) To Calls in Advance (For Calls received in ad- vance)	3,000	3,000
April 1.	Interest To Cash (or Bank) (Interest on Calls in ad- vance at 5 p.c. p.a. paid in advance).	150	150
April 15.	Mortgage Debentures Premium on Debentures Interest on Debentures To Cash (or Bank) (For 20 Debentures redeem- ed at a premium of 10 p.c. and interest £100)	2,000 200 100	2,300

*Question 4* - A B. sends goods to his auctioneers X & Company to be sold and instructs his brokers Y & Company, to buy in all lines not reaching a certain line. The result of the sale is that all goods are sold, realizing Rs 29,500 and remittances (less covering commission of 5 per cent) are forwarded by the auctioneers. The brokers have bought Rs 6,500 worth and their charges are 3 per cent. Part of the remittances received from the auctioneers is a draft at one month for Rs 8,000 accepted by Z & Company which on maturity is dishonoured. The auctioneers on being informed send a remittance for Rs 4,000 and a draft on Z & Company for the remainder, at one month, adding interest at 12 per cent per annum.

Write up cash account, auctioneers' account and Brokers' account in the Books of A. B.

*Answer :—*

**BOOKS OF A B.**  
**X & Co (Auctioneers) A/c.**

To Sale of Goods	Rs 29,500	By Commission	Rs. 1,475
„ Bills Received	8,000	„ Bills Receivable	8,000
„ Interest	40	„ Cash	20,025
		„ Cash	4,000
		„ Bills Receivable	4,040
Total	37,540	Total	37,540

**Y & Co. (Brokers) Account**

To Goods Purchase	Rs 6,500	By Commission	Rs 195
		„ Balance	6,305
	6,500		6,500

**CASH ACCOUNT**

To X & Co.	Rs. 20,025	By Balance	Rs. 24,025
„ X & Co.	4,000		
	24,025		24,025

*Question 5* – Wilson & Co. of Calcutta on May 1, 1947. sell and ship to Brown Brothers of London by s.s.

"Hooghly" a quantity of jute for £1,000. Against this shipment they draw a bill upon Brown Brothers at three months' date for £900, "with documents attached" in favour of the National Bank of India, and discount the bill with the National Bank of India, Calcutta, for £885. Explain the nature of this transaction, give the form of the bill, and show the entries (in pounds sterling) requisite to record correctly the matter in Wilson & Co's books

Answer—

Wilson & Co's Book.  
Brown Brothers A/c.

	Rs		Rs.
To Goods Sold	1,000	By Bills Receivable	900
	1,000		

Bills Receivable A/c.

To Brown Brothers	900	By Bank	885
	/	„ Discount	15
	900		900

BANK ACCOUNT

To, Bills Receivable Rs 885

DISCOUNT ACCOUNT

To Bills Receivable Rs 15



# ENGLISH COMPOSITION

## PART II

NOTE—As a matter of fact it would be an unprofitable task to give answers to questions on English as there is very little likelihood of a question being repeated in this subject. The same question in English is never set a second time and the Answers are useful only as illustrations. The readers are advised to read some standard works on Grammar if they are desirous of acquiring a thorough knowledge of the subject. In order that the students may have an idea of the style and standard of the paper the questions set at the previous examinations of the Indian Institute of Bankers are reproduced. Model Answers have been added to all the questions of grammar. Essays and precis may be set on indefinite number of subjects and particular subjects may be dealt with in many ways. Consequently, there is not much point in reproducing model answers.

### ESSAYS SET AT THE EXAMINATIONS

1. The Commercial Importance of South America.
2. The development of air transport and its effect on industry and commerce.
3. Discuss the desirability or otherwise of the elimination of the middleman in the retail sale of goods.
4. "Some books are to be tasted, others to be swallowed, and some few to be chewed and digested."
5. The causes of Britain's pre-eminence as a colonising nation.
6. The responsibilities of wealth.
8. "Better have failed in the high aim, as I  
Then vulgarly in the low aim succeed,"
9. "That almighty dollar. The great object of universal devotion throughout our land." (Washington Irving).

10 Arguments for and against the use of a universal script for All-India

11. Give a description of a commercial city as it will probably be in 100 years' time.

12. A prison has no right to exist if inmates discharged from it are not turned out better citizens than when they entered.

13. The advantages and disadvantages of travelling by road and rail.

14. The futility of perpetuating hostile feelings between any two nations.

15 *The wonders of wireless.*

16 Education should be for life, -not<sup>1</sup> for livelihood."

17. Recommending an ignorant community to make use of banks.

18 Life Insurance.

19. Tariffs.

20 The Bank Official's chances of studying human nature

21. The Earthquake in Bihar

22 The romance of bridges.

23 The futility of perpetuating hostile feelings between any two nations

24 Travel is a part of education

25. "The invention of machinery has been the death blow to art in industry "

26. The commercial possibilities of Broadcasting

27 Free Trade

28 Co operative Banks.

29 Direct and Indirect Taxation

30. Magistrates.

31. Commercial possibilities of air transport.

32. Importance of industrial peace.
33. An up-to-date business office.
34. Industrial combinations.
35. The life of a city clerk.
36. Technical Education.
37. The relations between Commerce and National Progress.
38. The morality of Strikes.
39. The development of Indian industries and commerce.
40. The arguments for and against a stamp tax on cheques.
41. Money-lenders.
42. Free and compulsory education
43. Totalitarian States.
44. The lessons of History.
45. India and World Trade
46. Labour conditions in India.
47. The Development of the Indian Film Industry.
48. The control of food prices.
49. The value of colonies
50. The advantages of pictorial advertisements.
51. Castles in the air.

## ENGLISH COMPOSITION

52. Democracy and its working.
53. Western influence on social and economic life of India.
54. Peace Aims
55. Village Moneylenders or Co-operative Banks ?  
Arguments for and against

56. Oil as a factor in the modern world.  
57. A. R. P.  
58. Co-Educational School  
59. The Mediterranean Sea  
60. Peace hath her victories no less renowned than war.  
61. The Food Problem  
62. Value of Discipline  
63. Banking as a career  
64. Future of Indian Shipping  
65. Business Integrity.  
66. Advertising as an Art  
67. Black Markets.  
68. India of the future  
69. Advantages and disadvantages of Industrialisation.  
70. Science is a good servant but a bad master.  
71. Profit Sharing

## LETTER WRITING

*Question* —(Answer either (a) or (b))

(a) A customer has purchased a Bank draft and subsequently informs the Bank that the draft has been lost requesting at the same time for the issue of a duplicate draft

Write to him regarding the procedure to be followed before a duplicate draft can be issued stating why such procedure is necessary.

(b) A customer approaches you with a view to obtaining a loan against certain Railway shares standing in his name

Write to your Head Office asking for sanction to make the advance and stating what steps you propose taking to register the bank's lien on the shares and to ensure that in

the event of the loan being called up the shares may be easily realized by the Bank.

*Answer :—(a)*

## POPULAR BANK LIMITED

Bombay, 31st December, 1947

MESSRS. JOSHI & Co.,

Duncan Street,

BOMBAY.

Dear Sir,

We are in receipt of your letter, dated the 30th instant, and note that our Demand Draft No. 20/455 for Rs. 3,500 drawn upon our Calcutta Branch, has been lost in transit and, therefore, you want a duplicate copy of it from use. You know, perhaps, that Demand Drafts belong to the class of Negotiable Instruments and can, therefore, be easily negotiated. The finder can, by forging the endorsement of the payee, obtain payment of a lost draft at any of the branches. It is, therefore, necessary for us to inform all our branches to guard themselves against the fraudulent use of the said draft. We have, therefore, to request you to please remit to us Rs. 3 to cover postage charges on the circular to be issued by us to our branches in this respect. As regards your request for a duplicate copy, we have to inform you that it would be necessary for you to execute an Indemnity Bond undertaking to hold the bank indemnified against any loss which may result through the negotiation or payment of the lost draft. The Indemnity Bond will cost you Re 1 and we shall, therefore, be glad if you will include this amount in your remittance to us. We shall be pleased to supply you with a duplicate copy of the Draft in question after we have heard from our Calcutta Office, to whom we are referring in the matter, that the draft reported to be lost has not as yet been paid by them.

Yours faithfully

X. Y. Z.

*Manager.*

*Answer :—(b)*

**POPULAR BANK LIMITED**

Lahore, 15th December, 1947

THE MANAGING DIRECTOR,

THE Popular Bank Limited,

BOMBAY.

Dear Sir,

We beg to inform you that Messers D. N. Mehta & Co. who own a big Rice Mill at this place have approached us with a request to grant them a loan of Rs. 5,000 against 200 shares of National Iron and Steel Products. The shares of the face value of Rs. 25 are fully paid up and stand in the applicant's name.

The applicants are prepared to execute the usual Demand Pronote in our favour and to furnish us with signed Blank Transfer Deeds.

The shares at present are quoted at Rs. 540 and we shall, therefore, be getting an ample security if the proposed advance is sanctioned since we shall not be advancing more than the face value of the shares, thus keeping a sufficient margin in the account.

The applicants are of substantial means and possess very valuable property in the city. They are, however, short of ready money and as they want accommodation for running the Rice Mill during the ensuing season, they have approached us for financial assistance. They expect to be able to repay the loan after six months.

We beg to recommend that the proposal be sanctioned at an early date.

Yours faithfully,

X Y Z

*Manager*

*Question —Answer either (a) or (b)*

(a) A local merchant has approached you for an advance against the pledge of 200 bales of cotton, his own absolute property.

Write to your Head Office asking for sanction to make the advance stating the reason and period for which the accommodation is required, the procedure you propose to adopt in taking the stock into your possession and how you intend to safeguard the Bank's interests while the debt exists. Append a detailed opinion on the party's means and standing, stating the source from which the information is obtained.

(b) A constituent has applied for an advance against your Branch Fixed Deposit Receipt for Rs. 5,000 in his own and his wife's name, payable to either or survivor

Reply agreeing to his request and advising him of the procedure to be followed in order to obtain the accommodation.

*Answer :—(a)*

POPULAR BANK LIMITED,

Lahore, 17th December, 1947.

The Managing Director,  
Popular Bank Limited,  
BOMBAY.

Dear Sir,

*Re: Advance against Produce.*

We have to inform you that Messrs N. B. Kapoor & Sons who are the leading Cotton Merchants of our town have approached to us for a cash credit limit against the security of 200 bales of cotton. The applicants are prepared to execute the necessary documents and keep the bales in their own godowns but under Bank's lock and key. Their cotton bales would be fully insured and the relative policy would be assigned in our favour. Messrs N. B. Kapoor & Sons are persons of reputable means and our enquiries made from independent sources go to show that they are worth not less than a lakh of rupees. They own some valuable property which brings them a substantial monthly rent. Besides, they are persons of good character and business integrity and we have no doubt about their ability to meet their obligations. Since we shall be getting a tangible security in the form of cotton bales, we have no hesitation in recommending the proposal to you for your early sanction. We shall be maintaining a margin of 25 per cent on the market value of the security. The applicants promise to adjust the account within six months' time. Kindly convey us your sanction at an early date.

Yours faithfully,  
X. Y. Z.  
Mav

*Answer:—(b)*

NATIONAL BANK OF HINDUSTAN

Bombay, 15th May, 1947

D. S. Biswas Esq.,  
5, Espalande Road,  
BOMBAY.

Dear Sir,

We are in receipt of your letter of 14th instant and as requested by you we shall be pleased to grant you an overdraft upto Rs 5,000 on the joint current account in your own and your wife's name against the security of this Branch Fixed Deposit Receipt No. 20490 for Rs 6,000 standing in like names.

We beg to enclose herewith a Demand Promote and a Letter of Authority instructing us to hold the receipt as security for the overdraft and to place the proceeds at maturity to the credit of the overdraft account.

Please return both the documents duly signed by you and your wife along with the fixed deposit receipt also signed by both. Kindly note that the Fixed Deposit Receipt should be endorsed over one anna revenue stamp.

Yours faithfully,

A B C,

*Manager*

*Question (a)*—A constituent's advance against paddy has become short of margin owing to a serious fall in the price of the commodity. As your calls for further margin have been ignored write to your Head Office explaining the position and submitting your recommendations. In the event of your proposing to sell the stocks, state what steps you would require to take should a short fall in the account occur.

*(b)* Another Branch has written asking for an opinion on the means and standing of a certain firm in your city. Reply in detail showing how you arrive at your estimate of their means and whether you consider them safe for ordinary business engagements.



*Answer:—(a)*

**POPULAR BANK LIMITED**

Lucknow, 20th December, 1937.

THE MANAGING DIRECTOR,  
The Popular Bank of India, Ltd.,  
BOMBAY.

Dear Sir,

*Regarding Advance against produce*

Messrs. X. Y. Z.

We beg to inform you that a demand loan for Rs. 15,000 was granted by us to the above firm on 5th March last against the security of paddy pledged to the bank and stored in godowns under our lock and key. It had been stipulated to maintain a margin of 25 per cent. on current market prices.

Owing to abnormal slump in commodity prices within the recent months, the account has become short of margin by Rs. 5,000 and our repeated requests to the party to replenish the deficiency have failed to produce the desired effect. As there is very little likelihood of rise in the price in the immediate future we have sent them today a final notice, registered A/d, stating that unless the account is adjusted by the 15th January 1938 we will proceed to sell off the stocks by private or public sale, holding them responsible for any short fall that may occur.

We shall be glad if you will confirm our action and authorise us should the account remain unadjusted on the dates specified to sell the stocks for what they will fetch and, if necessary, to file a suit against the borrowers for the resultant short fall which we estimate at Rs. 1,500 to Rs. 2,000. The present position of the account is as under.—

- (1) Bank's dues :—Rs 15,000 (Exclusive of interest at 6% per annum from 1st July 1,937).
- (2) Stock held by us —1300 bags of paddy.
- (3) Value of stock at the current market rate Rs. 13,750.

It is not out of place to add that the parties are very respectable and possess landed and house property, all unencumbered, worth at least Rs. 50,000. They are, however, short of

ready cash and have not, therefore, been able to meet our demands to cover the deficit in their goods account.

Yours faithfully,  
A. B. C.  
Manager.

Answer —(b)

GREAT ORIENTAL BANK LTD

Lahore, 16th Dec 1937

THE AGENT,  
Great Oriental Bank Ltd,  
JAMSHEDPUR.

Dear Sir,

In reply to your enquiry of the 10th instant, we beg to inform you that the firm in question has for some years carried on a retail iron mongery business in this town and appears to be making good progress. The proprietor of the business Mr M C is an industrious and shrewd man and, although not trading in a large way, is generally reputed to be possessed of some considerable means.

The New City Bank who are acting as bankers to the firm have furnished to us the following reports on their means, character and standing —

‘A firm of 25 years standing, worth about 1½ lacs enjoying good credit in the market’

We have also made independent enquiries respecting the firm and the result has been practically a corroboration of the New City Bank's report. The proprietor Mr M C owns six shops in a central locality and two residential houses all of which are said to be worth over Rs one lakh while he is reported to have invested about Rs 50,000 in his business.

As to the extent of the credit, we would say that the firm would keep any engagement upto Rs 50,000 and may be accommodated without security upto this extent

Yours faithfully,  
L. M. N.

Manager.

*Question.*—(a) A mill company has a Cash Credit Account at your branch for Rs. 10 lakhs secured by a promote drawn by the Mill Company in favour of the Mill Agents and endorsed by the latter to the bank.

In former years the mill was a flourishing concern but owing to poor management in recent years, the mill's position has deteriorated with consequent loss of credit to the mill agents.

The position of the Mill Company and that of the Agents is not such as would tender it advisable to call up the advance, but it is desirable that in addition to the existing security, further security of a more tangible nature should be taken by the bank.

Write to Head Office relating fully the facts which have led up to the present state of affairs and giving your recommendations for placing the advance on a more secure basis.

(b) A wealthy constituent who, when trade conditions were good, transacted very good business with the bank, now has an overdraft account only.

The drawing power of the account is Rs. 4 lakhs against the security of Government Papers for Rs. 5 lakhs but the balance drawn against the account except on a few occasions is small, while on many occasions the account shows a credit balance.

Write to the constituent tactfully, pointing out that this arrangement unremunerative to the bank and suggesting a means by which the bank would be assured of a certain fixed remuneration, by way of interest, on the account while still allowing the constituent the full use of the existing drawing power if, and when necessary.

*Answer:*—(a)

ORIENTAL BANK LTD.

Lahore, 15th January, 1948.

THE GENERAL MANAGER,  
Oriental Bank Ltd.  
BOMBAY,

Dear Sir,

*Re: Overdraft Limit for Rs. 10 lakhs  
enjoyed by Lyall Sugar Mills Co., Ltd.*

The above company was granted a cash credit limit for Rs. 10 lakhs secured by a Demand Promote drawn by them in,

favour of Messrs. Mehta & Co, managing agents of the mills and endorsed by the latter in favour of the bank. The account has been in our books for a pretty long time and has been maintained to our satisfaction. Owing to the imposition of an Excise Duty on Sugar, and keen competition amongst the Indian Sugar Mills the sugar industry is in a paralysed state. There is practically no margin of profit between the selling rate per maund and the cost of production. Several mills have either stopped the work or are contemplating to abandon it. The Lyall Mill Co has also not been able to escape from the injurious effects of excise duty. Its difficulties have been intensified by mismanagement. Frequent strikes and other labour troubles in which the mill has been involved during the last few months have created a worse situation for the managing agents. It is also reported that the managing agents have suffered huge losses in their other lines of business and have lost much of their credit in the upcountry markets.

All these facts predict a gloomy future for the Lyall Sugar Mills Co. The financial position of the managing agents does not warrant the continuance of the cash credit limit to the Company on their personal security. If pressure is brought upon them at this stage for the adjustment of the account, it is probable, that the managing agents being unable to liquidate the account may go into insolvency leaving the bank to rub their hands in grief. The only feasible course which suggests itself to us is to ask the managing agents to mortgage the mill including all buildings and machinery—with the bank. The value of the proposed security according to the latest balance-sheet, after allowing for the depreciation is Rs. 35 lakhs. Besides, it is entirely unencumbered. We had a talk on this subject with one of the Directors of the mill company and were informed that the Board of Directors would welcome the proposal to save the situation.

This is the only way in which we can secure our advance in the present circumstances. We request for a consideration of the proposal by your board. We shall be glad to furnish full particulars of the security and the manner in which it should be charged to the bank in case the board feels inclined to accept our suggestion.

Yours faithfully,

X. Y. Z.

*Manager.*

Answer .—(b).

GREAT ORIENT BANK LIMITED

Delhi, 10th December, 1947

D. K. SINGHAL, Esq.,  
Military Contractor,  
Connaught Circus,  
NEW DELHI.

Dear Sir,

We take the liberty to point out to you that in its present state your overdraft account in which you enjoy a limit of Rs. four lacs against the security of 5% Government Loan 1945—55 for Rs five lacs does not bring us a yield commensurate with the responsibility and risk shouldered by us. On a reference to the account we find that during September 1947 you had a balance of Rs 1,000 against you for 3 days only, in October the balance was Rs 2,000 for 5 days; while in November and December the account has been in credit throughout. We have earned hardly annas fifteen as interest on your account since September. We should have overlooked had a sufficient credit balance been left at times in the account but the balance in your favour has also been trifling, in fact it has never exceeded Rs. 500.

Our Auditors took a very serious objection to your account and instructed us to withdraw the facility or to insist for a minimum clause if the overdraft limit granted to you is to be continued. You will appreciate that our auditors' objection is not without reason. Even the safe custody charges on the securities lodged by you with us as cover against the overdraft would have been much higher than the interest yield by your account. You know that on your overdraft account you can draw upto Rs four lacs without giving us any notice. We have always to keep with us funds to become available to meet your drawings upon us whether you make them or not. This means a loss of interest to us. Under these circumstances, you will, we believe, find us justified in charging interest to you on a minimum monthly balance of Rs. 25,000. We have to request you to please make it convenient to call at our office during business hours to execute a fresh memorandum of deposit embodying the minimum clause.

Yours faithfully,

X. Y. Z.

Manager.

*Question* :—Answer either (a) or (b)

(a) A party of good standing wishes to establish business relations with the bank at your Branch and writes asking for your terms of business. Reply, informing him fully of the various types of business you can undertake and the terms and conditions on which such business will be conducted.

(b) You are Agent of a Branch Bank up-country and you find, as a result of touring the District, that there are good prospects of developing business, chiefly by way of advances to merchants, at a cotton and grain-growing centre at some distance from the branch. In order properly to develop the business it will be necessary to open a sub-office of the bank there.

Write to Head Office relating the above facts, recommending the opening of a sub-office, commenting on the standing of the merchants with whom you propose to do business, and stating the lines on which you think the business would best be conducted.

*Answer* —(a)

NEW DELHI BANK LIMITED,

Lucknow, 15th January, 1948

H DASTUR, ESQ.,  
5, The Mall,  
LUCKNOW.

Dear Sir,

We thank you for your letter of the 14th instant enquiring as to what kind of business we can undertake and asking for our rules and terms of business.

We are sure, you will appreciate, the advantages of a personal interview in such circumstances and we shall, accordingly, be very glad if you can arrange to call at this office, when we shall be placed to give you every information and assistance. The undersigned is available on any week day during ordinary banking hours.

We enclose herewith a copy of our rules of business. The leaflet will give you an idea of the various kinds of business handled by us and also the conditions under which Current Accounts are conducted. The charges involved in

each case must necessarily be determined according to the volume of each transaction. The literature which we have enclosed with this letter gives in detail rules which govern the various and diverse types of business handled by us but with a view to enable you to form an idea of our activities we take the opportunity to give in brief the regulations governing each kind of business.

(a) *Current Accounts* — Current accounts are maintained free of charge and interest is allowed at  $\frac{1}{2}$  per cent per annum on minimum monthly balances.

(b) *Deposits* — Fixed deposits are received for six months and over at suitable rates which may be ascertained on application.

It would perhaps interest you to know that our bank has recently introduced five years' cash certificates. They are issued for Rs 100 or multiple of Rs 100 at a cost of Rs 85 per 100 rupees. The interest yield comes to about 3.5 per cent at compound rate of interest. Our cash certificates have secured great popularity and have been found to be a profitable means of investment by the middle class people.

(c) *Advances* — Loans are allowed on demand promissory and over-draft against approved securities. The rate of interest in each case is determined by the nature of security lodged with the bank to secure the advances.

(d) *Foreign Business* — Our bank has got vast connections all over the world and is in a position to undertake foreign exchange business on almost all commercially important centres. It is needless for us to add that we have recently opened a subsidiary bank in London and this enables us to entertain business on England at competitive rates.

All these matters can be fully explained personally or on receiving particulars from you as to the kind and extent of services you will require from us. We shall be glad if you will write to us in reply.

Yours faithfully,

A. B. C.

Manager

Answer :—(b)

THE GRAND NATIONAL BANK, LTD.,

White Town, 16th December, 1947.

THE MANAGING DIRECTOR,  
The Grand National Bank, Ltd.,  
BOMBAY.

Dear Sir,

*Proposed New Branch at Green Town*

I have been watching with interest the development of the Green Town as an important commercial centre within recent years. The town is situated in a rich cotton producing and wheat growing area. I had the opportunity to go there in connection with the inspection of the factory of the Punjab Cotton Company, to whom finance is being provided by our bank against the stock of cotton in the factory area. I made a survey of the town, and was very much impressed with the prospects which it offers for the expansion of our activities.

Until recently, Green Town was little known, as it had no easy means of communication to link it with the other parts of the province. The construction of the Railway, which has now joined the town with White Town on the one side and Blue Town on the other, augurs well for it. The surrounding areas had been known for their dense forests and there was a considerably export of timber for fuel every year. Two years back the Government thought of establishing a Mandi (market) at Green Town, and with this end in view the huge forests were cut down. The construction of the B. D. Canal brought vast expanse of land under plough, and a barren land was converted into a fertile field. It was reported that last year 2 lakhs maunds of cotton were raised from the reclaimed land. The quality of cotton is superior than produced in the neighbouring areas, and therefore it finds easy market. Green Town, since the establishment of the Mandi, has also assumed the role of a collecting centre for wheat of the surrounding areas and is beginning to export large quantities every year.

Several of the local merchants approached me with a view that I should make representation to you for the opening of an office of our bank there. All the leading parties who have established their business at Green Town have been carrying on business for a considerable length of



the time at White Town and are personally known to me as of good reputation and business integrity

The town offers ample scope for investment against gold ornaments, but for the present I would suggest that our business should be confined to advances against cotton and wheat stored in godowns under bank's lock and key. The new office will, however, negotiate export bills which are likely to be offered in large numbers. Large consignments of wheat and cotton are despatched to Karachi and Bombay, and there is thus a considerable number and volume of export bills available in the market. Bill business, I hope, should provide sufficient income to the bank for running an office.

*Other Banks.*—There is no other bank at present in the town, and by opening an office of our own bank, we shall be extending our activities to a centre where no other bank is represented.

*Premises.*—I was able to arrange with Messrs XYZ. to give us on rent their spacious building which is situated in the busiest part of the town. They expect to have the building vacated in a month's time, and have agreed to place it at our disposal at a moderate rent. I have personally seen the building, and am of opinion that it would suitably serve our purpose.

*Recommendations.*—I recommend that the proposal be duly considered by the board and permission granted to me to open the office before the next wheat season commences. Should my proposal be accepted, I would suggest that for the present the office should be run by a clerk in charge and put under the control of our branch

Yours faithfully,  
A B C,  
Manager.

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*Question* — Answer either (a) or (b)

(a) A highly respectable trading firm, Messrs Smith Jones & Co., who are valued constituents of your bank, draw a cheque for Rs. 2,40,000 favouring the Victory Bank of India, Ltd., a Clearing Bank of the same city and a bank known to you to be interested in the Local Call Money Market. The cheque is presented for payment through first clearing (12-30 p.m.) when the firm's credit balance is only Rs. 9,000 and they have no overdraft arrangement.

You, however, hold a cheque for Rs 2,60,000 drawn by Messrs Smith Jones & Co. on the Asiatic Bank of India, Ltd.—also a Clearing Bank of the same city—for credit of the firm's account through second clearing. The fate of the latter cheque will not be known until 5 p.m. the same day, i.e., after business hours.

You pay the cheque favouring the Victory Bank of India, Ltd. as a special case and allow the cheque for Rs 2,60,000 to go through the Second Clearing in the ordinary course.

Write a tactful letter to your constituent firm drawing their attention to the irregularity with a view to avoiding a recurrence of the incident.

(b) You, as Agent of a Branch Office of a bank, are holding considerable stocks of Cotton (baled) as security for an advance to Mill Company. The cotton is stored in large godowns in the Mill Company's yard and as the result of serious outbreak of fire in one of the godowns, extensive damage is caused.

Report the matter to your Head Office by the first available outgoing mail (which is within 24 hours of the outbreak of fire) giving particulars of the situation, making special reference to the safety or otherwise of the bank's advance.

Answer —(a)

### ORIENTAL BANK LIMITED

Calcutta, 6th January, 1948.

Messrs. SMITH JONES & Co.,  
65, Clive Street,  
CALCUTTA

Dear Sir,

We beg to inform you that a cheque for Rs 2,40,000 drawn by you in favour of Victory Bank of India, Ltd., was presented to us for payment through the first clearing. The balance at your credit at that time was only Rs 9,000 and, as a matter of principle, we had no alternative but to return the cheque as unpaid, since no overdraft arrangements have been made by you with us. On an enquiry from the Cash Department, we learnt that you had paid in for your credit a cheque for Rs 2,60,000 drawn by you on the

Asiatic Bank of India Ltd., but the cheque in question having been received by us after 1 p.m. it was to be presented for payment through the second clearing. The fate of this cheque could become known to us after 5 p.m. and it was, therefore, not possible for us to honour the cheque presented through the first clearing relying upon your own cheque received by us for collection. In order that your credit may not suffer we paid the cheque but, you will appreciate, that in taking such a step we courted a grave risk. We need scarcely remind you that, in accordance with the rules of our business governing current accounts, cheques cannot be drawn against bills, cheques etc. received by us for collection unless they have been actually realised.

Under the circumstances, we have to request you to please see that in future you do not draw upon us in such an irregular manner as you have done in the present instance. Should you, however, require to overdraw your account in the future, we should be obliged if you would make arrangements to this effect with the bank. By so doing you will materially assist the work of the bank and preclude the possibility of any cheques being returned unpaid for lack of funds.

Yours faithfully,  
X.Y.Z.  
Manager.

*Answer : -- (b)*

GREAT ORIENT BANK, LIMITED

Lyallpur, 6th March, 1948.

THE GENERAL MANAGER,  
Great Orient Bank Limited,  
BOMBAY.

Dear Sir,

*Re : Punjab Cotton Mills Co., Ltd.*

We regret to inform you that a godown containing 200 bales of cotton belonging to the above company and situated in the compound of their own mill caught fire and was totally destroyed. The cause of the fire is not as yet known but it is believed that a spark coming out of the chimney of the mill passed through the ventilator of the godown and fell upon loose cotton which was lying in the same godown in which the cotton bales in question had been stored. The loose cotton was soon on fire and the cotton bales were also involved. Before the fire-brigade could reach, the godown had been gutted down and the contents reduced to ashes.

The cotton bales of the mill company were pledged to the bank as security against the cash credit account which this day shows a debit balance of Rs 15,000 exclusive of interest from 1st January 1937. The stock was fully insured with the New Insurance Company Limited and the Policy assigned in our favour. As soon as the occurrence of the fire came known to us we wired to the Insurance Company concerned as under :—

*"Fire in godown Punjab Cotton Mills loss estimated  
Rs. 20,000 arrange assessment"*

As soon as assessment is over we shall receive the amount of the claim from the Insurance Company and get our account adjusted. We may add that if the claim of the borrowers against the Insurance Company is fully admitted, which is likely to be, we shall be recovering our dues in full.

Yours faithfully,  
A. B. C.  
Manager.

Question :—Answer either (a) or (b)

(a) An Anglo-Indian constituent of the Branch in which you are serving dies, leaving (a) a current account credit balance of Rs 3,600 in his single name, and (b) Government Securities worth Rs. 14,000 in safe custody in his single name. Write a reply to an enquiry from the widow of the deceased advising her how she should proceed with a view to obtaining possession of the deceased's assets. The bank had received no previous intimation of the party's death.

(b) The Managers of five Scheduled Banks in your centre convene a meeting to discuss the advisability of establishing a Clearing House and eventually decide in favour. Report the matter to your Head Office.

Answer —(a)

NEW DELHI BANK LIMITED,

Agra, 7th October, 1947.

MRS. M WHITE,  
6, Pall Mall,  
FARGAON,

Madam,

We have to acknowledge receipt of your letter of the 1st instant and very much regret to learn of the death of your husband.

2. It will now be necessary for you to obtain, from a competent Court, legal representation to the estate of your deceased husband in the form applicable according to the circumstances of the case. If your husband has left a will it will be necessary, preferably through your Solicitors, to prove the will and obtain Probate thereof from the Court, If he has left no will, your Solicitors will require to apply to the Court of Letters of Administration, authorising you (or some other nominated person) to collect the assets of your late husband and thereafter deal with them according to law

3. Our Executor and Trustee Department, which is accustomed to handling matters of this nature, will be very pleased to assist you with the administration of the estate if you so desire, and we enclose a copy of our booklet giving details of the procedure to be followed.

4 We confirm that there are Government Securities of the face value of Rs. 14,000 lying with us in Mr White's single name and also a current account balance of Rs 3,600

5. In the meantime, please send us a Death Certificate for registration in our books, and advise us if we can assist you in any way with the legal formalities now necessary,

Yours faithfully,

A. B. C.

Manager.

Answer .—(b)

### GREAT ORIENT BANK LIMITED

Amritsar, 7th October, 1947.

THE GENERAL MANAGER,  
Great Orient Bank Ltd ,  
CALCUTTA,

Dear Sir,

*Re . Cleaning House for Amritsar.*

We beg to inform you that within recent months there has been a substantial increase in the number of local cheques which this branch has been receiving for collection from the up-country branches and agents The average number of cheques per day for the last month came to 65, Similarly, the number of cheques which have been presented upon us for payment by other local banks has considerably

arisen As no Clearing House had been in existence in this town the cheques had to be presented through our walk-clerk and it took him the whole day to present such cheques and receive payments. I took the opportunity to take the opinion of the Managers of the other scheduled banks operating here as to the advisability of establishing a Clearing House for this place so that we could minimise the labour and expense in collecting cheques. All of them consented to support my proposal and an informal meeting was arranged in our bank premises to chalk out the lines on which the Clearing House may be run. In addition to the undersigned, the managers of the following banks took part in the deliberations of the meeting.

(1) Prosperity Bank Ltd., (2) Paramount Bank Ltd.,  
(3) Grand National Bank Ltd., (4) Apex Bank Ltd.

It was decided that the Apex Bank should serve as a Clearing Bank and transactions relating to the Clearing House should be handled by it. It was also decided that the representative of each Member-Bank should assemble at 2 p.m. in the premises of the Apex Bank for the purposes of carrying on clearing business. It was further resolved that for the present there should be one clearing at 2 p.m. but should the volume of the business permit the number of clearings may be increased to two, first at 12 noon and the second at 2 p.m.

Yours faithfully,

A B C

G

Manager.

Question — Answer either (a) or (b)

(a) On arrival at your office one morning you find that you have lost the key of the Strong Room and despite diligent search the key cannot be traced. You communicate with the nearest Branch where the duplicates in the safe custody and obtain the duplicate in due course.

Report the matter to your Head Office stating what precautions you have taken to safeguard the bank's interests.

(b) Draft an appropriate skeleton certificate addressed to the Head Office of a Bank, suitable for use in the case of one agent having taken over charge of a Branch from another.

*Answer —(a)*

**GREAT ORIENT BANK LIMITED,**

Jubbulpur, 19th January, 1948.

**THE GENERAL MANAGER,  
Great Orient Bank Ltd,  
BOMBAY.**

Dear Sir,

I regret to have to advise that on arrival at office this morning, I discovered that the key of the Branch Strong Room was missing. The key was in my possession when I left my bungalow this morning, but appears to have fallen from my pocket on the way to the office. A thorough search has been, and is still being made, but so far it has not been traced.

So that there should be as little dislocation in the Office as possible, I wired immediately to Suntown Branch asking them to despatch this branch's duplicate keys by the quickest possible means. Fortunately, the cheque book issued to us by the Apex Bank with whom we are keeping a current account was lying in another safe the keys of which were in my possession. I issued a cheque for Rs 50,000 upon the Branch current account and commenced the day's work. By this means there was no interruption in our normal business and the duplicate keys arrived by messenger at 2-30 p.m.

Until such time as the key is found or the setting of the Strong Room Door lock is altered, I have arranged with the D. S. P. to post a police guard of 1 Head Constable and 4 Constables inside the Branch Premises.

Even although the missing key is eventually traced, I beg to suggest that the setting of the lock levers be altered and a new key obtained, and I shall be obliged if you will kindly arrange to send Messrs. Fishlock's representative to undertake the resetting of the lock as soon as possible.

I very much regret the occurrence of this incident, but would assure you that all regulations for the safety and custody of the key were being observed without exception.

Yours faithfully,

A. B. C.

*Manager.*

*Answer:—(b)*

Place .....

Date.....

THE MANAGING DIRECTOR,  
Great Oriental Bank Ltd.,  
BOMBAY.

Dear Sir,

I beg to report that I have taken over complete charge of the Branch including —

- (a) Cash on hand,
- (b) Branch accounts with other Banks.
- (c) Branch accounts with Head Office and other Branches
- (d) Securities held against advances—Loan Overdrafts, Local Bills discounted, Cash Credits etc
- (e) Branch Investments in Government papers, Shares in Joint Stock Companies etc.
- (f) Important Securities
- (g) Safe Custody articles
- (h) Bullion, gold and silver ornament held as security against advances
- (i) Furniture and Stationery.
- (j) Bank's property.

The branches and other Banks' accounts were reconciled and found in order. I have checked the godowns and verified the stocks held as security against Cash Credit Accounts. All Books have been balanced

Mr . . . has been relieved from to-day forenoon  
afternoon

Yours faithfully,

A. B. C.

*Agent.*

*Question — (a)* You are in charge of a small up-country branch of your bank, distant one day's journey from your Head Office, and have a staff of six clerks. Your senior clerk is injured in a motor accident and likely to be in hospital for several weeks. At the same time, one of your



remaining clerks is away with fever, and another has just returned to duty after an illness and is not capable of strenuous work. You decide you must have assistance immediately from your Head Office —

Write a copy of your telegram to your Head Office asking for senior relief clerk to be sent to you at once, and write a confirming letter to them giving your reasons for requiring assistance urgently and explaining briefly how you propose to adjust the work till your staff is at full strength.

(b) As is a customer of your branch and has an overdraft arrangement with you up to Rs. 10,000 against industrial shares, duly charged to your Bank, which were, when the arrangement was made, valued at Rs. 20,000 according to the then market quotations. There has recently been a general fall in share prices and, at the current quotation, the shares held by you against this overdraft are only worth Rs 75 per cent of their market value when you fixed the limit, while the future trend of the market is very uncertain. You decide that you must have the limit reduced to Rs. 7,500 on the existing security, or that, otherwise, further security, must be deposited

Write an appropriate letter to A, informing him of the position and asking him to make such arrangements as are necessary to comply with your requirements

*Answer.*—(a) The telegram may be sent in the following form :—

‘ Hands unavoidably short send one senior relief immediately letter follows.’

The confirmation of this telegram may be drafted as under —

Ahmedabad 4-3-1918.

THE MANAGING DIRECTOR,  
POPULAR BANK OF INDIA.  
BOMBAY.

Dear Sir,

#### REGARDING STAFF

When I came to the office this morning I was informed that while our Ledger Keeper Mr A was coming to the office his cycle collided with a Motor Car and he was

knocked down. He had to be removed to the hospital in an unconscious state. He is still lying in a precarious condition and is likely to remain away from the office for a fortnight. Another Clerk, Mr. B has not been attending the Office since Monday last as he is down with typhoid. It is probable that he may not attend to his duties for a week more. Mr. C, our senior Clerk, has just returned from long leave of two months, but since he has only recently recovered from his illness, his physical condition does not allow him to shoulder heavy burden of the work. I am carrying on the work of the Branch with only three persons but I feel that the work is so heavy that it is not possible for the present staff to cope with it. I have been, therefore, compelled to send you a telegram this morning as under —

"Hands unavoidable short send one senior relief letter follows"

Which I now confirm. I trust you would have ordered one of your relieving clerks to join us. I may require his services for a fortnight but in any case he will be relieved no sooner one of the two clerks, who are now on sick leave, re-joins the office.

Yours faithfully,

X. Y. Z.

*Manager.*

*Answer.—(b)*

### POPULAR BANK OF INDIA

Lahore, 20-3-1948]

D. R. Mehta Esq.,  
14, The Mall,

Dear Sir,

On second January 1939, when you last called here you were informed that your application for the overdraft limit of Rs 10,000 had been granted by our Head Office.

We then pointed out to you that this bank made a term of an agreement to advance money to a customer that such loan should at no time exceed 50% of the value of the security which is deposited to secure the account, and that it was within our discretion to ask you to deposit further security or reduce the balance at any time, failing which the bank would not be under any obligation to continue the advance.

In pursuance of this agreement you deposited with us as security—

50 fully paid up shares of Rs. 100 each in the Indian Steel Company			
Market Value	...	Rs. 10,000	0 0
200 shares of Rs. 60 each in the National Copper Corporation			
Market Value	...	Rs. 10,000	0 0
		Total Rs.	<u>20,000 0 0</u>

You are probably aware that the share market witnessed a steep slump during the last few days owing to tense political situation in Europe. The shares of industrial companies have suffered worst and on revaluation of your security we find that the total market value now comes to Rs. 15,000. The market conditions are still uncertain and there is a likelihood of the prices of the shares sagging further. Your account is overdrawn to the limit of Rs. 10,000 and therefore the total value of your security estimated by us at Rs. 15,000 falls short of the required margin by atleast Rs. 2,500.

In these circumstances we must ask you either to arrange to reduce your overdraft by that amount or to deposit additional security.

Yours faithfully,

A. B. C.

*Manager.*

*Question.*—(a) In the annual report of the working of your branch for 1939, which disclosed increasing business, you have pointed out that your present local premises are not sufficiently large for the business of the branch: but at that time, you were unable to find any more suitable premises available elsewhere in your town. You have since found out that certain premises, which you consider eminently suitable, will shortly be vacant and that you can obtain them at an economical rental. Also that, if your bank were agreeable, the premises could alternatively be purchased at a comparatively low figure, which you consider preferable to taking them on a lease. You recommend that the bank should take these premises.

Write a letter to your Head Office giving details of the premises, their suitability for the business of the branch—from the points of view of site and construction—and the reasons for your considering it preferable to purchase them rather than take them on a lease.

(6) You have some weeks ago issued to one of your customers, a person of small means, a draft on your Colombo branch, drawn in duplicate in favour of third party. Your customer advises you that the draft has been lost by the payee and asks for a fresh draft to replace it. This of course you are not prepared to give without an adequate indemnity, and, further, you consider it desirable to obtain more definite detail as to how the draft came to be lost and what has happened to the duplicate of the draft.

Write a suitable letter to your customer, asking him to let you have more detailed information as to the loss and explaining to him the nature of the indemnity your bank will require, before a fresh draft can be issued, at the same time raising the question of the disposal of the duplicate of the missing draft.

Answer —(a)

### POPULAR BANK OF INDIA

Lahore,

4th January, 1948.

THE MANAGER,  
POPULAR BANK OF INDIA,  
BOMBAY.

Dear Sir,

#### Re. Premises

We beg to point out that the present premises were acquired by us on rent when we newly opened our branch at this place. At that time we had a staff of 10 clerks but soon after our business expanded to great dimensions and we went on increasing the strength of the Staff till at present there are twenty-five clerks and four officers working here. The present premises are proving insufficient and cannot easily accommodate the whole staff. Besides, they are situated in a part of High Street which is somewhat remote from the best business part of the thoroughfare and our customers are put to a great inconvenience in transacting business with us. It is, therefore, highly advisable that we should shift ourselves to some other suitable premises.

Exceptionally central and prominent freehold premises with a frontage of 150 ft. and with a depth of 100 ft. situated at the Napier Road corner will become vacant very shortly. They consist of one Big Hall measuring 75 x 50 feet, two office rooms each measuring 30 x 20 and few more back rooms which can be used for Record, Stationery and Godowns. All the rooms are well lighted by windows, have electric installation, and have heating and cooling arrangements. The building is in the busiest part of the town and if we shift to it we shall be placed in a position to provide service to many of our customers at their very doors. This would naturally lead to the development of our business still further.

The premises belong to Mr R. K. Mehta who offers them to us for Rs. 50,000 or he would agree to grant a lease for ten years at Rs. 450 per mensem. We enclose a photograph of these premises and we do not think that the cost of altering them to suit banking requirements would be considerable. We are of opinion that the bank should go in for these premises rather than take them on lease. The Bank shall have to invest Rs 50,000 plus a small amount, say Rs. 2,000 on alterations and additions to make the premises suited to our requirements. Considering the easy money market condition and the present deposit rates at which long term deposits can be had the annual cost to the bank will not be more than Rs. 2,000. Obviously there will be a considerable saving to the bank in rent in case our suggestion is adopted.

We shall be glad if our letter is placed before the Board and their views communicated to us so that we may begin our negotiations with the landlord before the present lease expires

Yours faithfully,  
X. Y. Z.  
Manager.

Answer : - (b)

POPULAR BANK OF INDIA,

Bombay,  
4th January 1948.

J. K. RAMA, Esq.;  
24, Duncan Road,  
Bombay.

DEAR SIR,

Re: Lost Draft

We are in receipt of your letter of the 3rd inst. advising

us of the loss of D/Dft No. 6/56 for Rs 1,000 issued by us in favour of Percy R. Menon on our Colombo Branch. You have not, however, given to us the full details as to how the payee happened to lose the draft, nor you have stated the disposal of the 2nd of exchange of the said draft. You are aware that the draft in question was drawn by us in a set of two. The idea was that the original draft should be sent by you to the payee by first mail and the duplicate copy by the following mail so that in the event of the original draft going astray in transit the beneficiary could utilise the duplicate draft and receive its payment and thus avoid any loss. It seems that you did not observe this precaution and sent both drafts to the payee by the same mail. If we are wrong in our presumption, kindly inform us what has happened to the duplicate draft.

We are unable to supply you with a fresh draft without making enquiries from our Colombo Branch to satisfy ourselves that the previous draft has not been paid by them and at the same time asking them to guard against its fraudulent use. Even if the draft is reported to be outstanding you will be required to execute jointly with the payee an indemnity bond on one rupee paper undertaking to hold the bank harmless and to indemnify it against all losses resulting through our issuing a fresh draft.

We shall revert to the subject after hearing from our Colombo Branch to whom we are addressing to-day

Yours faithfully,

X. Y. Z.

*Manager.*

*Question (a)*—A manufacturing company with an account at your branch requires additional funds in the first fifteen days of each month about the 15th of each month their debtors invariably pay more than sufficient to clear off the overdraft. No good security can be given, as the company has issued debentures to a large amount. Report to the head office as to the circumstances and make recommendations.

*(b)* Write to the secretary of a limited company the account of which has been overdrawn without advice to you. You wish to retain the connection and have accordingly honoured cheques on presentation.

Answer—(a)

Popular Bank of India Ltd.,  
Lahore,  
1st January 1948.

The General Manager,  
POPULAR BANK OF INDIA Ltd.,  
Bombay.

Dear Sir,

**Re: Punjab Textiles Ltd.**

The above company, which is registered under the Indian Companies Act as a Public Limited Company, is one of the biggest clients of our branch having dealt with us for the last ten years. It manufactures cotton piece-goods for which a large demand has risen in our province owing to the fall in the imports of foreign cotton goods due to the present European war. The Company is making large profits and the Directors hope not only to clear all the arrears of dividend on preference shares but also to pay a dividend of at least ten per cent. to the ordinary shareholders.

The company is keeping a current account with us in which an average daily balance of Rs 15,900 has been maintained during the last six months. It, however, withdraws whole of its balance in the first week of the month as it has to meet its bills for cotton purchased by it in the market. Its own available resources being insufficient to cover such purchases it requires additional funds for the purpose. Its arrangements with its own debtors are to allow them a credit of one month and generally they pay the company's bills after the 15th of a month so that the company has enough funds after the 15th of each month to clear the overdraft which its drawings upon the bank may create in the earlier part of the month. But the company has no security to offer to secure such a temporary overdraft. It has issued 6 per cent debentures for Rs. 2 lacs secured by a charge on the fixed as well as floating assets of the company viz. Land and Building, Plant and Machinery, Stock in Trade etc. It has, however, a reserve liability of the shareholders for unpaid capital to the extent of Rs. one lac on which the bank can rely as a security in the event of the company's failure although there are very remote chances of such contingency arising on account of the prosperous times which now await the company.

It remains to add that the overdraft will not exceed Rs 20,000 in any month and will be subject to an interest of four per cent per annum. It is, therefore, recommended

that the proposal may please be considered favourably and your decision communicated to us in due course.

*Answer :—(b)*

**Popular Bank of India,**  
**Lahore,**  
*1st Jany., 1948.*

Messrs. KRISHNA TRADING CO. Ltd.,  
*Lahore.*

Dear Sir,

Kindly note that by payment of our cheque for Rs. 12,000 favouring Mr Homi Mehta your account shows a debit balance of Rs. 3,000 (Rupees Three Thousand) at the close of business to-day

We think it advisable to inform you of this in case it may be due to any error on our part, or in case a remittance intended for the credit of your account may not have reached the Bank.

Yours faithfully,  
X. Y. Z.  
*Manager.*

*Question (a).—*Your customer, Major Smith, commanding a detachment of signals sends a cheque in for his credit made payable to "the Officer Commanding, District Signals or Order" Write to him and explain why you are unable to credit his account with the amount of the cheque and suggest ways for overcoming the difficulty.

*(b)* One of your customers, a motor firm, has recently undertaken a new agency and requires finance for the purchase of new cars. Write to your Head Office outlining your ideas for helping your customers and giving Head Office sufficient information about the Company, to enable them to give you a decision

*Answer —(a)*

**POPULAR BANK OF INDIA**

**Bombay, 25th January, 1948.**

Major Smith,  
Officer Commanding District Signals,  
Bombay

Dear Sir,

We are in receipt of your letter] dated 24th instant



together with a cheque for Rs. 1,000 favouring the Officer Commanding District Signals which you want us to credit to your personal account on realisation. In this connection we have to point out that the cheque being payable to you in your official capacity, we regret to say that we are unable to give effect to your instructions for it is against the established principles and practice of banking to collect cheques for an agent, when on the face of them they represent trust money. The cheque having been received by you in a fiduciary capacity must necessarily go into the credit of your Unit's account and not into your personal account. Since the cheque is uncrossed we can pay the amount to you on our counter on your giving us a discharge on the cheque in your official capacity.

Yours faithfully,  
X. Y. Z.  
Manager.

Answer :—(b)

### POPULAR BANK OF INDIA

Lahore, 5th May, 1947.

The General Manager,  
Popular Bank of India,  
Bombay.

Dear Sir,

*Re : Lahore Automobile Co.*

The Lahore Automobiles Co. are one of our valued customers. They deal in motor cars, trucks and accessories and have recently been successful in acquiring agency of Chivalry Car for Northern India. They have approached us for an overdraft of Rs 50,000 for financing their new business. They have no objection to put the new cars bought by them from their principals in our possession as security. The cars will remain in their own show rooms but shall be locked by the bank and shall not be removed from the premises without our express permission. The cars shall be insured for their full value in Bank's name with some approved Insurance Co. The firm agree to maintain at all times a margin of 25% on the value of cars which shall not be advanced against in excess of their Invoice Value.

The firm is a highly respectable and well founded concern and we feel assured that we can rely upon their business acumen in any engagements to which they may commit themselves. The partners A. B. C. and X. Y. Z. command

a fair credit in the market and are reputed to be men of substantial means. In dealing with them our money shall not be open to any serious risk. The proposal is worth considering and we shall be pleased if it receives your approval. We enclose herewith a financial report on the bank's standard form on the firm which gives an estimate of their worth as computed by us and corroborated through independent sources.

Yours faithfully,  
S. R. P.  
Manager.

### WORDS AND IDIOMS

*Question*—Write five short sentences, each containing one of the following words correctly used so as to bring out its full meaning:

**Mobilise**, inevitable, monopoly, analogous.

*Answer*.—**Mobilise**=To call into service as troops ;

*Illustration* :

Banks can render a useful service by mobilising the idle capital of the country.

**Inevitable**=Not able to be avoided, cannot be escaped,

*Illustration* :

The inevitable result of the failure of the Great Powers to prevent war between China and Japan would be a world war.

**Monopoly**=The sole power of dealing in anything.

*Illustration*

The Exchange Banks in India hold a virtual monopoly of foreign exchange business.

**Analogous**=bearing some correspondence with, or resemblance to.

*Illustration:*

The principle on which the Law of Diminishing Returns is based is analogous to the Law of Substitution.

*Question.*—Give the meanings of the following phrases:—

A new broom; A clean sweep; On the carpet; To burn one's fingers; To water down; To pin down; To score off; To face the music; To shut up shop; To talk shop.

*Answer.*—**A New Broom**=Newly appointed official eager to sweep away abuses.

**Clean sweep**=Complete riddance.

*Illustration:*

New brooms clean sweep.

Persons newly appointed to office or position zealously and enthusiastically correct the mistakes made by their predecessors. Also those recently installed wish to introduce new methods and sweep away the old.

**On the carpet**=Under discussion.

**To burn one's fingers**=To get into trouble.

*Illustration:*

He burnt his fingers by interfering in his neighbour's affairs.

**To water down**=To make (details of story etc.) less vivid or horrifying

**To pin down**=To bind (person etc.)

**To score off**=It is a slang term meaning to inflict some humiliation on.

**To face the music**=To accept the situation at its worst, to face one's critics; not shirk.

**To shut up shop**=To abandon any enterprise, to cease doing anything.

**To talk shop**=To talk exclusively about one's business and professional affairs.

*Illustration*

It is not etiquette to talk shop on social occasions.

**Question** —Compose brief passages each containing one of the following phrases (The wording of the phrase may be modified if necessary).

To throw up the sponge ; to sing small ; to pay the piper ; a fool's paradise ; double or quits, to kick over traces ; salad days , to bury the hatchet , to come to hand.

**Answer** —**To throw up the sponge**=To surrender in despair

*Illustration*

He tried repeatedly to explain but eventually threw up the sponge.

**To sing small**=To assume a humble tone, to play a minor part.

**To pay the piper**=To bear the cost or charges.

The Chambers of Commerce may call for the tune, but the people will have to play the piper.

**A fool's paradise**=A state of felicity based on fictitious hopes.

*Illustration*

He lives in fool's paradise who depends on memorising and thinks he has finished his education by those means.

**Double or quits**=In gambling, said when a stake due is either to become double or be reduced to nothing, according to the issue of a certain chance.

**To kick over the traces**=To throw of control.

**Salad days**=Days of youthful inexperience

*Illustration*

Now are not your salad days and you must begin to feel your responsibilities

**To bury the hatchet**=To cease fighting, to make peace

*Illustration:*

Let us now bury the hatchet and work for the advancement of the country.

To come to hand=To be delivered.

*Question.*—Give accurately the meaning of each of the following expressions or words. Use each correctly in a sentence so as to bring out its meaning:—

- (a) The handwriting on the wall.
- (b) To be a square peg in a round hole.
- (c) To exact one pound of flesh.
- (d) A Quixotic scheme.
- (e) A busman's holiday.

*Answer.*—(a) *Handwriting on the wall*—An inscription or indication of threatening disaster, an ill omen; something mysterious, allusion to Belshazzar's feast where the words *Mene, Mene, Takel Upharsin* were written on the wall. Belshazzar was slain.

*Example* Your talk is like the handwriting on the wall.

(b) *A square peg in a round hole*—A person who does not fit in with his surroundings or, is not suited to his occupation.

*Example:* Though his brother's influence got him the agentship it became soon evident that he was a square peg in a round hole.

(c) *To exact one pound of flesh.*—To demand the utmost penalty of Law as did Shylock of Antonio in Shakespeare's Merchant of Venice.

*Example.* All efforts for a compromise failed since he would exact nothing but a pound of flesh.

(d) *A Quixotic Scheme.*—A romantic and absurd plan.

*Question.* Write ten short sentences each containing one of the following words correctly used so as to bring out its full meaning:—

Sumptuous, Mitigate; Leeway; Universal; Continuous; Automatically; Athwart; Pertinent; Wherewith; Judicial.

*Answer* — **Sumptuous** = Costly ; magnificent.

*Illustration* :

We had a sumptuous dinner at Rama's house yesterday,

**Mitigate** = To lessen the severity of

*Illustration* :

I hope this remedy will mitigate your sufferings, even if it cannot entirely relieve them.

**Leeway** = The drifting or deviation of a ship to the leeway of her course To make up leeway meaning to 'overtake work in arrears'.

*Illustration* .

Much leeway has been made in scaling down the permanent debt of the agriculturists in the last decade.

**Universal** = Comprehending, affecting or extending to the whole.

*Illustration* .

Mahatma Gandhi is held in universal esteem for his peace-making efforts. .'

**Continuous** = Joined together without interruption.

*Illustration* .

The continuous noise made by the drum-beaters disturbed him in his studies.

**Automatically** = Without any action from outside ; of itself

*Illustration* .

A printing machine which works automatically has been recently invented

**Athwart** = Wrongly, perplexingly

**Pertinent** = To the point.

*Illustration*

He raised a pertinent question when he asked the objects of the movement which the leaders wanted to initiate

**Wherewith**=With which.

*Illustration :*

He has not the requisite capital wherewith to carry on the business.

**Judicial**=Pertaining to a judge or court of justice ; established by Statute.

*Illustration :*

The judicious separation enabled both of them to live independently of each other.

## FIGURES OF SPEECH

*Question.*—Explain fully with illustrations five of the following terms.—Metaphor Antithesis, Bathos, Climax, Hyperbole, Euphemism, Tautology, Solecism.

*Answer.*—1. **Metaphor.**—Metaphor is an implied resemblance in one particular of things which are otherwise unlike it. It expresses one thing in the terms of another, implying thereby that one thing is another. It may be used as a Noun and an Adjective or a Verb.

*Illustrations—Noun :—*

- (a) His eldest son is the star (brightest member) of the family.
- (b) He is now in the sun-set (decline) of his family.

*Adjective :—*

- (a) He missed a *golden* opportunity.
- (b) He delivered a *fiery* speech yesterday.

*Verb :—*

- (a) The town was *stormed* after a long siege.
- (b) He was fond of blowing his own trumpet (praising himself).

2. **Antithesis**—Just as in Similes and Metaphors two or more things are brought together for the purpose of resemblance so they are brought together in Antithesis for the

purpose of contrast. One idea is set against another in order that the stronger may out-weigh the weaker and secure prominence thereby. This figure of speech is employed as an effective means of obtaining clearness and impressiveness.

*Illustrations :*

(a) As Ceaser loved me I weep for him , as he was fortunate I rejoice at him , as he was valiant I honour him , but as he was ambitious, I slew him. There is tear for his love, for his fortune , honour for his valour ; and death for his ambition.

(b) They speak like saints and act like devils.

3. **Climax** means a ladder in Greek, and the word is used to denote a figure of speech which suggests climbing. The writer leads to his main point by degrees, beginning with the least important idea and ending with the most important. In other words, Climax expresses a gradation of ideas each of which is contrasted with the preceding one

*Illustrations :*

(a) Some books are to be tasted, others to be swallowed, and some few to be chewed and digested.

(b) Threaten him ; imprison him ; torture him , kill him , you will not induce him to betray his country

4. **Bathos** —It is the opposite of Climax and is, therefore, called also anti-climax. The least important idea is put last and, therefore, signifies descent from the higher to the lower.

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## COMMON ERRORS AND THEIR CORRECTIONS

*Question* —In the following notices and sayings confused thought has led to confused expression and use of words ; amend or explain them .

(a) No more room inside unless you go on top.

(b) For sale a gold watch by an old lady about to cross the Channel in a Wash-leather case



- (c) No vehicle drawn by more than one horse is allowed to cross this bridge in opposite direction at the same time.
- (d) Sit on the end of stove and stir constantly.
- (e) Candidates may bring with them pens, pencils and blotting-paper. But the invigilator has power to prohibit the use of all these things.
- (f) Row the race of life with your eyes fixed firmly on the goal.
- (g) The old prison will be used while the new is being constructed. The new prison will be erected from the materials of the old prison.
- (h) For sale. A bull dog : will eat anything, very fond of children.

*Answer.*—(a) What the speaker intended to mean was that there was no more room available in the ground floor and the visitor could be accommodated if he cared to go to the upper storey.

(b) "For sale, a gold watch in a wash-leather case by an old lady about to cross the Channel." (In this sentence the rule of proximity has been violated. The general rule is that the parts of a sentence that are most closely related in thought should be placed nearest to each other. The words *in a wash-leather case* relate to the *watch* and should, therefore, be placed near to it).

(c) "Vehicles drawn by more than one horse are not allowed to cross this bridge at the same time in opposite directions." (Want of care in the use of qualifying phrases has produced confused and slipshod writing. The sentence has, therefore, been wholly re-cast.)

(d) "Sit by the end of the stove and stir constantly." (One cannot sit on the end of the stove. *On* should be replaced by word *by* to mean near the stove.)

(e) "The candidates may bring pens, pencils and blotting paper with them but the supervisor has power to prohibit the use of any of these things." (*pens, pencils* etc., should be placed close to *bring* in orders that the rule governing the position of words may be fully observed. *Invigilator* is wrong word and should be replaced by *Supervisor*. But is a conjunction and should, therefore, be

used to join the two sentences. The full stop should, therefore, be omitted and the two sentences made continuous)

(f) "Row the race of life with your eyes fixed firmly on the goal" (The meaning conveyed by the sentence is that one should not give the object of his life but should endeavour, while he lives in the world, to achieve the goal)

(g) The two sentences convey contradictory meanings. If the old prison is to be used while the new is under construction, it is beyond one's comprehension how the material of the old prison can be used for the construction of the new.

(h) "For sale a bull dog, very fond of children; will eat anything." (The words *very fond of children* if used after *will eat anything* convey the idea that the dog is fond of eating children although the notice intended to indicate that it loves children).

**Question.**—(Alternative). Write five short sentences each containing one of the following words correctly used so as to bring its full meaning—Affect, collusion; mutual; transpire, intermittent; unique.

**Answer.**—

**Affect**—The noise affects his study.

**Collusion**—A secret agreement to deceive.

**Illustration.**

The thieves acted in collusion with the police

**Mutual**—Equally affecting two or more—

**Illustration.**

It was thought that the agreement was made with the idea of bringing mutual advantage to the subscribing parties

**Transpire**—becoming public

**Illustration.**

The whole story at length transpired and everybody came to know of what had happened

**Intermittent**—Ceasing at intervals—

*Illustration:*

The intermittent spring added to the beauty of the park.

**Unique**—Without a like or equal.

*Illustration:*

This is believed to be unique instance in the political history of India.

*Question.*—Correct the errors of the following sentences:—

- (a) Hurrying along the road dropped suddenly towards the river, about a mile away.
- (b) Bicycles are not allowed on the maidan; anyone doing so will be prosecuted.
- (c) He writes like his father does.
- (d) Scarcely had he started than he turned back.

*Answer:—*

- (a) As I hurried along the road dropped suddenly towards the river, about a mile away.
- (b) Bicycles are not allowed on the maidan; anyone bringing them for (or violating this rule) will be prosecuted.
- (c) He writes as his father does.
- (d) Scarcely had he started when he turned back.

*Question*—Correct the following sentences if necessary and give the reasons for your alteration:—

- (a) There can be no question of friendship between you and I.
- (b) I can only count 14 persons present at the meeting.
- (c) The reasons for these sort of things are obvious.
- (d) I ask you to kindly think before you speak.

*Answer.*—(a) It should be "between you and me".  
The pronoun should be in the objective case

(b) It should be, "I can count only 14 persons present at the meeting." "Only" is misplaced. It is connected with "person" and not with "count" and should, therefore, be placed immediately before "persons". As it is the sentence suggests a meaning different from that is intended.

(c) The reason for this sort of things is obvious. Reason being singular should be followed by a singular verb. Moreover only one sort is indicated, "sort" is singular and so "these" should be "this".

(d) Ask may be replaced by request because "Ask" implies subdued command whereas an advice is intended. "To" should be removed to follow "kindly".

**Question**—Rewrite the following sentences and state briefly the reasons for any changes in construction made by you —

- (a) Mr. James White of Calcutta met with a serious accident last week, he is now quite an old man.
- (b) He went on a sea voyage in consequence of ill-health.
- (c) He was fined for breaking a plate-glass window with a stick value Rs. 25 the property of Mr X.
- (d) On attempting to extract the bullet the patient began to sink rapidly.
- (e) Many thanks for your letter [which I have forwarded to Mr. Smith and asked him to write direct to you.
- (f) The illegibility of his writing caused great difficulty and the typist could not copy it.
- (g) The brave only deserve the fair.

**Answer**—The "rule of proximity" or the "position of words" is based on the fundamental principle that things which are to be thought of together must be mentioned together *i.e.*, as closely together as the context permits. The same rule applies to the position of qualifying phrases and subordinate clauses. In the following sentences confused thoughts have been produced as the rule of

proximity, has been overlooked. The sentences should be re-cast as under. —

(a) "Mr. James White of Calcutta who is now an old man, met with a serious accident last week."

(b) "In consequence of ill-health, he went on a voyage."

(c) "He was fined for breaking with a stick a plate glass window valued Rs. 25 and the property of Mr. X (The words *with a stick* refer to *breaking* and should therefore, be placed close to it).

(d) "On our attempting to extract the bullet the patient began to sink rapidly." (The Gerund-verb noun—must not be used so that its implied subject differs from the subject of the sentence, unless it is qualified by a possessive objective. The sentence may also be rewritten as under :—

"On an attempt being made to extract the bullet etc . . ."

(e) "Many thanks for your kind letter which I have forwarded to Mr. Smith. I have asked him to write directly to you" (In this sentence *which* is understood in the subordinate clause *and asked.....to you*. The words *which* are employed only when a relative has been used in the sentence. Here *and which* is shown to be relative to *letter* although the words have reference to Mr. Smith. The sentence, has therefore, been wholly recast as above).

(f) "The illegibility of his writing caused great difficulty to the typist who could not copy it." (The words *caused great difficulty* do not indicate to whom the difficulty was caused).

(g) "Only the brave deserve the fair." (In this sentence *only* is caused to qualify a wrong word).

Question — Correct the following sentences giving your reasons for any change you make :—

(a) It is not me he injures so much as himself.

(b) I shall have great pleasure in accepting your invitation.

- (b) If I were old enough to marry, I am old enough to manage my own house!
- (d) The river has overflowed its banks.
- (e) To aim at public and private good are far from consistent.

*Answer.*—"It is not I he injures so much as himself" "It is" should be followed by a personal pronoun in the nominative case and not by a personal pronoun in the objective case.

2. "I have great pleasure, etc. The preposition "in" indicates that the pleasure is attendant upon the act of "accepting" and is contemporary with it.

3. "To aim at public and at private good are far from being consistent". The word "consistent" logically necessitates the idea of two things according with each other, the two things are "aiming at public good" and "aiming at private good". The preposition must, therefore, be repeated, because otherwise "public and private good" is bracketed together as the object of the single verb "to aim." When "at" is repeated, "to aim" is understood after "and", hence the plural verb "are" has a plural subject.

4. "The river has overflowed its banks" "Flown" is the past participle of "fly", not the past participle of "flow".

5. "If I am old enough to marry, I am old enough to manage my own house," or "If I were old enough to marry, I should be old enough to manage my own house." The sentence, as written, combined an if-clause involving a condition incapable of fulfilment, with a then-clause involving a condition capable of fulfilment. It was, therefore, illogical.

*Question*—Correct the following sentences, giving full reasons for any changes made.—

- (a) The whole block of buildings including two furniture stores and a drapery establishment, were destroyed by the fire
- (b) My friend is more skilful than me in dealing with these kind of problems.

- (c) In this year the monsoon failed, which caused a terrible famine throughout the provinces.
- (d) I had hoped to have found that more progress had been made.
- (e) Of all the other qualities necessary to achieve success, perseverance is the more important.

*Answer.*—(a) “The whole block of building including two furniture stores and a drapery establishment *was* destroyed by the fire”. (Replace the plural verb *were* by the singular verb *was* to agree with its singular subject *block*. The verb *was* has been wrongly attracted to the plural *were* by the proximity of “two furniture stores and a drapery establishment,” a parathetical phrase qualifying *block*).

(b) “My friend is more skilful than I in dealing with these kinds of problems” (*Thin* should be followed by a pronoun in the Nominative Case and as such *me* should be replaced by *I*. *These* is plural demonstrative adjective and should qualify a plural noun. *Kind* should be changed into *kinds*).

(c) “In this year the monsoon failed and this caused a terrible famine throughout the province”. (*Whch* is unrelated and should, therefore, be replaced by *and this* to indicate the failure of the monsoon which was the cause of a terrible famine).

(d) “I had hoped to find that more progress had been made.” (Perfect Infinitive to *have found* implies action completed prior to that of the main verb *have hoped*. The present infinitive to *find* is here required)

(e) “Of all the qualities necessary to achieve success, perseverance is the most important.” (Omit *other*. By using *other*, perseverance is wholly excluded from the class of qualities to which perseverance claims to belong).

Replace *more* by *most*. The Superlative here is required as comparison is being made amongst more than two things. The sentence may also be recast thus.

“Perseverance is more important than any other quality which is necessary to achieve success.”

**Question.**—Rewrite the following sentences in good English explaining precisely what is wrong with each:—

- (a) I shall have great pleasure in accepting your kind invitation: we will be happy to visit you.
- (b) He seldom looked at the picture, which he frequently did, without shedding tears.
- (c) A clergyman in Perthshire wishes to purchase a small pony to do the work of a minister.
- (d) Italy is a narrow tongue of land, the backbone of which is formed by the Appennines.
- (e) There were very few passengers, who escaped without serious injury.

**Answer**—(a) "I shall have great pleasure to accept your kind invitation and shall be happy to meet you." ("In accepting" excludes the idea and should, therefore, be changed into *to accept*. *We will* should also be replaced by *I shall* as *we* is a plural number while its antecedent is singular. *Will* shows firm determination and should, therefore, be changed into *Shall*, to indicate willingness).

(b) "He frequently looked at the picture but seldom without shedding tears." (The rule of proximity has been ignored in this sentence. The general rule is that the parts of a sentence that are mostly related in thought should be placed nearest to each other. The writer means to say that 'he seldom looked at the picture without shedding tears.' Hence the sentence has been wholly re-cast as above)

(d) "Italy is a narrow tongue of land and its backbone is formed by the Appennines." (Want of care in the use of qualifying phrase has produced confused and slipshod writing. The conjunction which joins *Appennines* with the *tongue of land* meaning that *Appennines* form the backbone of the *tongue of land* whereas the idea intended to be conveyed is that *Appennine* form the backbone of Italy)

(e) "There were very few passengers who escaped serious injuries." (*Without* should be omitted altogether, as it is superfluous)

**Question.**—Rewrite the following sentences in good English explaining precisely what is wrong with each:—

- (a) I am neither an individualist in theory or practice.



- (b) Wanted, a gentleman of good ability and pleasant manners to travel throughout North India.
- (c) Neither the religion of the Missionaries nor the trade of the merchants is the cause of the anti-foreign movement in China, though both have been used as levers to envenom it.
- (d) We admit the gift's generosity, but the Corporation in accepting it will, we believe, be found to have saddled themselves with a white elephant.
- (e) I never remember to have felt an event more deeply than his death.

*Answer.*—(a) "I am individualist neither in theory nor in practice." *Neither* and *nor* should agree with the other words of speech in the sentence.)

(b) "Wanted a gentleman of good ability and pleasant manners to travel throughout Northern India." (*North* is a noun and should, therefore, be replaced by the adjective *Northern* to qualify *India*. A noun cannot qualify a noun.)

(c) The sentence does not require any modification.

(d) We admit the donor's generosity, but the Corporation in accepting the gift will, we believe, be found to have saddled themselves with a white elephant" (*Generosity* is shown by the *Donor* of a gift and not by the gift itself. Hence *donor's* should be substituted for *gift's*. It will be used if its antecedent has already been employed in any of the previous sentences. If no antecedent has already been used it will be replaced by the words *the gift*).

(e) "I remember never to have felt an event more deeply than his death." (*Never* has been used to modify a wrong word).

*Question.*—Express in plain prose the ideas contained in the following:—

- (a) The pen is mightier than the sword.
- (b) The trumpet of Fame hath sounded his deeds afar.
- (c) He doth bestride the narrow world like a Colossus.
- (d) By his tactful speech he succeeded in pouring oil on the troubled waters.

- (e) Consider your position carefully before you cross the Rubicon.
- (f) It is unwise to swap horses while crossing a stream.
- (g) He is modern Croesus.
- (h) Sceptere and crown must tumble down.  
And in the dust be equal made  
With the poor crooked scythe and spade.
- (i) Is not a patron, my lord, one who looks with unconcern on a man struggling for life in the water, and, when, he has reached ground, encumbers him with help?" (Dr. Johnson).

*Answer.*—(a) What sweet words can accomplish, repression cannot.

- (b) Because of his deeds he became known far and wide.
- (c) He exercises a vast influence over the world, and can mould the world according to his wish.
- (d) By his tactful speech he was able to allay angry feelings and pacify the audience.
- (e) You must consider your position carefully before you take a decisive step in any enterprise after which there is no turning back.
- (f) It is not prudent to make a bargain when you are not in a position or are in a difficult position to do so.
- (g) Croesus was the king of Lydia and was said to be very rich. The word has now come to be used for a wealthy man. "He is a wealthy man in modern time."
- (h) Death draws no distinction between a king and a beggar. Both are made of dust and are returned to dust. They are made equal by death.
- (i) It is an ironical definition of the word 'patron'. He is described to be one who does not lend any support to a man when he is in difficulty but makes a lavish offer of his help when it is not needed.

*Question.*—Explain the meaning of :—

- (i) Are you content to make a virtue of necessity ?
- (ii) Where ignorance is bliss, 'tis folly to be wise.
- (iii) The loud laugh that spoke the vacant mind.
- (iv) The boast of heraldry, the pomp of power.

*Answer :—*

- (i) Are you ready, while doing what you cannot help doing, to let it seem a good action done of your own free will.
- (ii) If you are taking an advantage and other people do not know about it you should carry on your pursuit without informing them. Let sleeping dogs lie.
- (iii) Real pleasure can be felt by a man whose heart is not burdened with worries and anxieties.
- (iv) Those who boast of descent from noble ancestors and those who attain position of power and splendour.

*Question.*—Re-write in plain English so as to bring out the full meaning :—

- (a) Stone walls do not a prison make,  
Nor iron bars a cage.
- (b) The practical business of the Society will be conducted by the Executive Committee or Council, five to form a quorum
- (c) One touch of nature makes the whole world kin.
- (d) Discretion is the better part of valour.
- (e) Are you content to make a virtue of necessity ?

*Answer.*—(a) A man who loves freedom is not afraid of a prison. His love for liberty cannot be suppressed by any repressive measures.

(b) The Executive Committee or Council will be responsible for carrying on the practical business of the Society

In order to conduct the proceedings of the Executive Committee it is necessary that 5 members of the Executive Committee may be present at a meeting. Sometimes a committee is composed of a large number of members and as it is difficult for all the members to be present in a meeting one of the bye-laws of every society provides that a certain number of members of the committee should be present and form a quorum in order that the proceeding of meeting may become valid and binding upon the other members.

(c) It is nature which makes a man realise his relationship with other men, may he be of any colour, caste or creed

The touch of nature which makes the whole world kin is found by the traveller under all circumstances and he learns to understand others by seeing their surrounding, way of life and the influence that bear upon it.

(d) The chief excellence of bravery lies in prudence.

Follow the following sentence.—

The Deputy Collector was non-plussed and thinking that discretion is the better part of valour vanished.

(e) Are you ready, while doing what you cannot help doing, to let it seem a good action done of your own free will

### Miscellaneous Questions.

*Question.*—Give a single word for each of the following definitions (a) Quite certain to happen, (b) Unable to bear with opinions different from one's own's own, (c) A post of profit or honour with no duties attached to it; (d) Conscientious, even in small matters, (e) Having no like or equal or parallel, (f) A man who keeps very strict discipline, (g) A person free from national limitations, (h) The unravelling of the complications in the plot of a play, novel, etc (i) To determine from symptoms the nature of a disease

*Answer.*—(a) Inevitable, (b) Intolerant, (c) Sinecure, (d) Scrupulous, (e) Unparalleled, (f) Disciplinarian, (g) Cosmopolitan (h) Denouement, (i) Diagnose

*Question.*—Rewrite the following dialogue in continuous narrative in reported speech throughout:—

I said to Ali Effendi, "If we are to save these people we must get back the cattle that have been driven away, and their bed and bedding",

"Effendi," he replied, "You are asking the impossible. We do not even know who has stolen the thing; neither can we tell which cow or which sheep belongs to this person or to that. As for the bedding that they have taken away that is easily disguised." "But", he continued, "I have been ordered to do just as you command me. Whatever you say that I shall do at your instruction."

*Answer.*—I said to Ali Effendi that if we were to save those people must get back the cattle that had been driven away and their bed and bedding. Addressing me by name he replied that I was asking the impossible. None of us know who had stolen the things; neither could any of us tell which cow or which sheep belonged to which person. As for the bedding that they had taken away, he was of the opinion, that was easily disguised. But continuing his speech, he added, that he had been ordered to do as I commanded to him, and so whatever I said, he would do at my instruction.

## PRECIS WRITING

*Question*—Give in your own words the substance of the following reported speech, reducing it to about one-third of its present length:—

"Mr. Darcy and I" said Mr. Wickham, "are not on friendly terms, and it always gives me pain to meet him. His father, Miss Bennet, the late Mr. Darcy, was one of the best men that ever breathed, and the truest friend I ever had; and I can never be in company with this Mr. Darcy without being grieved to the soul by a thousand tender recollections.

"The late Mr. Darcy," continued Mr. Wickham, "bequeathed me the next presentation of the best living in his gift. He was my godfather and was excessively attached to me. I cannot do justice to his kindness. He meant to provide for me amply, and thought he had done it; but when the living fell, it was given elsewhere."

"Good heavens!" cried Elizabeth, "but how could that be! How could his will be disregarded? Why did not you seek legal redress?"

"There was such an informality in the terms of the bequest as to give me no hope from law. A man of honour could not have doubted the intention, but Mr. Darcy chose to doubt it, and to assert that I had forfeited all claim to it by extravagance, imprudence, in short, anything or nothing. Certain it is that the living became vacant two years ago, exactly as I was of an age to hold it, and that it was given to another man; and no less certain is it, that I cannot accuse myself of having really done anything to deserve to lose it. I have a warm, unguarded temper, and I may perhaps have sometimes spoken my opinion of him and to him too freely. I can recall nothing worse. But the fact is that we are very different sort of men and that he hates me."

"This is quite shocking! He deserves to be publicly disgraced."

"Some time or other he will be but it shall not be by me."

"Till I can forget his father, I can never defy or expose him"

"Elizabeth honoured him for such feelings and thought him handsomer than ever as he expressed them"

"But what," said she, after a pause, "can have been his motive? What can have induced him to behave so cruelly?"

"A thorough determined dislike of me—a dislike which I cannot but attribute in some measure to jealousy. Had the late Mr. Darcy liked me less, his son might have borne with me better, but his father's uncommon attachment to me irritated him, I believe, very early in life. He had not a temper to bear the sort of competition in which we stood the sort of preference which was often given me"

Elizabeth was again deep in thought, and after a time exclaimed, "To treat in such a manner the godson, the friend, the favourite of his father!" she could have added, "A young man, too, like you, whose very countenance may vouch for your being amiable" But she contended herself with—"And one, too, who had probably been his own companion from childhood, connected together, as I think you said, in the closest manner."

*Answer:—*

### **Mr. Wickham's Disappointment**

Mr. Wickham related to Miss Elizabeth Bennet the reasons for his estrangement from Mr. Darcy. He told her that he used to be a great favourite of Mr. Darcy's late father, who during his lifetime treated him with very great kindness and bequeathed him the presentation of the best living in his gift. Mr. Darcy, did not, however, carry out his father's clear intention and did not appoint Mr. Wickham to the living when it fell vacant. A technical flaw in the will precluded Mr. Wickham from asserting his claim legally to the bequest. Moreover, the memory cherished by him of the late Mr. Darcy's affection towards him would not permit him to speak ill of his son in public. Mr. Wickham further said that Mr. Darcy intensely disliked him, because he was piqued at his father's marked partiality for Mr. Wickham.

Elizabeth who inwardly admired Mr. Wickham for his handsome appearance and magnanimity, expressed her indignant disapproval of Mr. Darcy's conduct.

*Question —* Write a precis of the following passage.—

You will be surprised at hearing from a stranger. No introduction has, nor in all probability ever will authorize that which common thinkers would call a liberty; it is, however, a liberty which, although not sanctioned by custom, is so far from being reprobated by reason, that the dearest interests of mankind imperiously demand that a certain etiquette of fashion should no longer keep "man at a distance from man", or impose its flimsy fancies between the free communication of intellect.

The name of Godwin has been used to excite in me feelings of reverence and admiration. I have been used accustomed to consider him a luminary too dazzling for the darkness which surrounds him. From the earliest period of my knowledge of his principles, I have ardently desired to share, on the footing of intimacy, that intellect which I have delighted to contemplate in its emanations.

Considering, then, these feelings, you will not be surprised at the inconceivable emotions which I learned your existence and your dwelling I had enrolled your name in the list of the honourable dead. I had felt regret that the glory of your

being had passed from this earth of ours. It is not so; you still live, and, I firmly believe, are still planning the welfare of human kind.

I have but just entered on the scene of human operations: yet my feelings and my reasonings correspond with what yours were. My course has been short, but eventful. I have seen much of human prejudice, suffered much from human persecution, yet I see no reason hence inferable which should alter my wishes for their renovation. The ill-treatment I have met with has more than ever impressed the truth of my principles on my judgment. I am young, I am ardent in the cause of philanthropy and truth; do not suppose that this is vanity; I am not conscious that it influences this portraiture, I imagine myself dispassionately describing the state of my mind. I am young, you have gone—before me I doubt not, are a veteran to me in the years of persecution. Is it, strange that, defying prejudice as I have done, I should outstep the limits of custom's prescription, and endeavour to make my desire useful by a friendship with William Godwin?

I pray you to answer this letter. Imperfect as may be my capacity, my desire is ardent and unintermitted. Half an hour would be at least humanely employed in the experiment I may mistake your residence; certain feelings, of which I may be an inadequate arbiter, may induce you to desire concealment; I may not, in fine, have an answer to this letter. If I do not, when I come to London, I shall seek for you. I am convinced I could represent myself to you in such terms as not to be thought wholly unworthy of your friendship, at least, if desire for universal happiness has any claim upon your preference, that desire I can exhibit. Adieu! I shall earnestly await your answer.

### Precis

The writer, in his letter to Mr. Godwin, stated that he had taken the liberty to write to him though he was a stranger to him, because he thought that the etiquette of custom should not prevent free communication of intellect between man and man. He liked Mr Godwin's principles and admired him and had a desire to share his intellect. He had taken him as dead, but it surprised him to know of his existence

He had started life only very shortly, but his feelings and ideals were not different from those of Mr. Godwin. He had suffered from human persecution like him, yet he still



believed in their uplift in philanthropy and truth. He was seeking friendship of Mr. Godwin against customary etiquette because he was a veteran to him. The writer admitted that though his capacity might be insufficient, his desire was sincere. He might not perhaps receive a reply because Mr. Godwin might like to conceal his whereabouts. He would, however, seek for him in London and would show him that he was not unworthy of his friendship because of their common desire for universal happiness.

*Question.*—Write a precis of the following passage :—

Before I pass to a review of your business, there is a point relating to the internal organisation of the Bank which should be of interest to shareholders. You are aware that, in order to maintain, as far as possible, that close personal touch between the Bank and its customers, which was characteristic of the private banks from which Barclay Company Limited, was originally formed, we adopted a system of decentralised control of our country branches, through Local Boards. Subsequent amalgamations, which furnished us with branches in other parts of the country, did not in every case provide the means of establishing immediately this method of control, but we have gradually filled the gaps by the creation of new Local Head Offices, and I am pleased to say that, with the formation, a few weeks ago, of a local Head Office at Swansea to control the branches in West Wales, our network of Local District is now complete. The system is also applied, in a limited degree to London, where we have three Local Head Offices representing the old private banking firms of Barclay Bevan, Tritton & Company, Ranson Bouverie & Company, and Gosling and Sharpe, in Lombard Street, Pall Mall East, and Fleet Street, respectively. This system provides for the administration on all but major matters by Local Directors and District Managers possessing local knowledge and an understanding of the problems of their respective areas, and I am convinced that it is of great value both to the Bank and to its customers. We enjoy the advantage of having members of our Board who are also Local Directors and as such are in daily touch with the affairs of the Bank in one or other of our Local Districts.

The twelve months covered by our accounts—a year made memorable by the Coronation of our King and Queen—have been eventful in many respects. The year has been industrial production in this country and employment of insured workers raised to record high levels, an improvement

in the position of the special areas, advancing wages and company profits, and rising internal and external trade. It has not been, however, without its anxieties, which, as the months have passed, may have served to cause some diminution in that confidence which has carried us through five years of recovery. The political outlook abroad has remained clouded, and the situation has been disturbed by the continuance of civil war in Spain and by the outbreak of hostilities in the Far East between China and Japan.

In the United States of America, there has been a definite decline in business activity, which, in view of the economic importance of that country, must be taken into account in considering the prospects for world trade. It would appear, however, that the reasons underlying much of the recession in business on the other side of the Atlantic have been domestic rather than international, and in so far as the remedy lies in the hands of the United States, it is to be hoped that lost confidence will soon be regained, and the private enterprise will be encouraged to exercise its influence towards the betterment of trade in that country, which is so important a factor in world prosperity.

The trade is good in the United Kingdom at the moment, no one will deny. All the evidence we have goes to show that this is indisputably the case. But the very existence of this satisfactory state of things causes some people, unwilling to count their blessings, to look with unwholesome persistence for the "Slump" which they feel must of necessity be round the corner. We should have a proper sense of values. That bad times follow good is common knowledge, and trade charts, with their peaks and depressions, supply evidence of this; but, as the stage is set to-day—and it is a different setting from that of 1929—there is little justification for undue concern. We must count ourselves fortunate that we, in this country, have a measure of general prosperity which is by no means universal. But no country can prosper in isolation, and every effort would, therefore, be made to widen the circle of well being, so that all nations may share in the improvement which scientific and technical developments have made possible. In accepting with proper appreciation and thankfulness, the condition of affairs at home, we must not be unmindful of the part played by our Government, which through its administration of our national finances, its trade negotiations, and its contacts with industry, has done

much to restore confidence to the trading community, for confidence is the breath of life to business, and its absence produces that state of hesitation and half heartedness which lowers the general system, and has a paralysing effect on all enterprise.

Whatever the future may hold, we may safely say that on balance we are in a stronger position to meet any changes which may cause fluctuations in the level of prosperity than we were only a few years ago. Taking all the various factors into consideration, therefore, we may regard the year 1937 as one of further progress, and this is reflected in the accounts which have been submitted to you and to which I now propose to refer in some detail.

### Precis

In the annual report of the Barclay's Bank for the year 1937, the Chairman stated that as regards its internal organisation, the bank from its very formation, had adopted a system of decentralised control of country branches through local boards in order to maintain personal touch with their customers. It was, however, not possible to extend immediately the same system to other branches which were acquired by subsequent amalgamation. New local head offices were, therefore, established to fill up the gap and with the opening of a local Head Office at Swansea, the organisation was made complete. The same system was also applied to London, where they had three local Head Offices. The system of administration of all but major matters by persons with local knowledge and of having on the Board the local Directors was advantageous both to the Bank and the customers.

The year under review which was made memorable by the Coronation of their Majesties witnessed an alround improvement in trade and industry. The confidence was, however, diminished on account of the political situation arising from the Spanish Civil War and the outbreak of hostilities between Japan and China.

In the U. S. A. trade declined, mainly because of domestic reasons, but it might be hoped that confidence would be restored, leading to improvement in trade which is an important factor in world prosperity.

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Trade in U K was good at the time, but some people felt that on the analogy of 1929, the slump was inevitable. This anxiety was, however, unwarranted because the conditions then differed from those in 1929. The people of U K were more fortunate than those of other countries enjoying prosperity, but it was desirable to widen its sphere. The recovery was in no small extent due to the wise administration of national finance by the Government.

On the whole, the year 1937 was one of further progress and this was reflected in the account of the Barclay's Bank for the year under review.

END



